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No. 85-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

ARKLA ENERGY RESOURCES,
a division of Arkla, Inc.
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission, acting under Section 5 of the Natural Gas Act, can fundamentally and permanently alter the service authorized by longstanding certificates of public convenience and necessity or can do so, if at all, only under the procedures and standards of Section 7 of that Act.

PARTIES TO THE PROCEEDING

In addition to Arkla Energy Resources* and the Federal Energy Regulatory Commission, the following persons were parties in the court of appeals:

Algonquin Gas Transmission Company
Aluminum Association, The
American Iron and Steel Institute
ANR Pipeline Company
Association of Business Advocating Tariff Equity

Brooklyn Union Gas Company, The

Cascade Natural Gas Company
Chattanooga Gas Company, a division of
Jupiter Industries, Inc.
City Gas Company
Colorado Interstate Gas Company
Columbia Gas Transmission Corporation
Consolidated Gas Supply Corporation
Consumers Power Company

El Paso Natural Gas Company
Equitable Gas Company

Foothills Pipe Lines (Yukon) Ltd.

Georgia Industrial Gas Group, The
Great Lakes Gas Transmission Company

Illinois Gas Company
Inter-City Gas Corporation

Madison Gas and Electric Company
Michigan Consolidated Gas Company

*Arkla Energy Resources is a division of Arkla, Inc., which is not affiliated with any companies other than its wholly-owned subsidiaries.

Michigan Gas Utilities Company
Michigan Public Service Commission, The
Midwestern Gas Transmission Company
MIGC, Inc.

Natural Gas Pipeline Supply Company of America
Northern Illinois Gas Company
Northwest Energy Company, on behalf of
Northwest Pipeline Corporation and
Northwest Central Pipeline Corporation
Northwest Natural Gas Company

Pacific Gas and Electric Company
Pacific Interstate Offshore Company
Pacific Lighting Gas Supply Company
Pacific Offshore Pipeline Company
Pan-Alberta Gas Ltd.
Panhandle Eastern Pipe Line Company
People of the State of California, The
Peoples Gas Light and Coke Company, The
Process Gas Consumers Group, The
Public Service Commission of the State of New York
Public Service Commission of Wisconsin, The
Public Service Electric and Gas Company
Public Utilities Commission of the
State of California, The

Southern California Gas Company
State Corporation Commission of Kansas
State of Michigan, The

Tennessee Gas Pipeline Company, a
division of Tenneco, Inc.
Texas Eastern Transmission Corporation
Texas Gas Transmission Corporation
TransCanada Pipelines Ltd.
Transcontinental Gas Pipe Line Corporation

Transwestern Pipeline Company
Trunkline Gas Company

Washington Gas Light Company
Washington Natural Gas Company
Wisconsin Fuel and Light Company
Wisconsin Gas Company
Wisconsin Gas and Electric Company
Wisconsin Natural Gas Company
Wisconsin Power and Light Company
Wisconsin Public Service Corporation

TABLE OF CONTENTS

Page

OPINIONS BELOW 2

JURISDICTION 2

STATUTES INVOLVED 2

STATEMENT OF THE CASE 2

A. *Background* 2

B. *The Commission's Orders* 4

C. *The Impact on Arkla* 5

D. *The Decision Below* 6

REASONS FOR GRANTING THE WRIT

THIS CASE PRESENTS A QUESTION OF FIRST IMPRESSION CRITICAL TO THE ADMINISTRATION OF THE NATURAL GAS ACT 7

A. *The Commission's Minimum Take Orders Effect a Fundamental Change in Certificated Service* 8

B. *NGA Section 5 Does Not Authorize Fundamental Changes in Existing Certificates* 10

C. *Resolution of the Commission's Authority to Modify Existing Certificates is Necessary to End Industry Confusion that Jeopardizes Future Financing of Pipeline Facilities* 13

CONCLUSION 15

APPENDIX

TABLE OF AUTHORITIES

Page

JUDICIAL DECISIONS:

Atlantic Refining Co. v. *Public Service Comm'n* 360 U.S. 378 (1959) 7,11

CAB v. *Delta Air Lines, Inc.*, 367 U.S. 316 (1961) 13

FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972) 8,12

FPC v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) 12

Michigan Power Co. v. *FPC*, 494 F.2d 1140 (D.C. Cir. 1974) 12

Mobil Oil Corp. v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972) 7

Permian Basin Area Rate Cases, 390 U.S. 747 (1968) 7

Reynolds Metals Co. v. *FPC*, 534 F.2d 379 (D.C. Cir. 1976) 11,12

United Gas Pipe Line Co. v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) 12

United States v. *Seatrain Lines, Inc.*, 329 U.S. 424 (1947) 13

ADMINISTRATIVE DECISIONS:

Cities Service Gas Co., 38 F.P.C. 364 (1967) 5

Northwest Central Pipeline Corp. v. *Arkansas Louisiana Gas Co.*, 28 FERC ¶ 61,211 (1984). . 5

Trunkline LNG Co., 22 FERC ¶ 63,028, *aff'd*, 22 FERC ¶ 61,245 (1983) 13,14

TABLE OF AUTHORITIES

STATUTES: **Page**

Administrative Procedure Act:
- 5 U.S.C. § 551(7) (1982) 11
- 5 U.S.C. § 551(8) (1982) 11
- 5 U.S.C. § 551(9) (1982) 11
- 5 U.S.C. § 558(c) (1982) 11

Natural Gas Act:
- Section 4, 15 U.S.C. § 717c (1982) 12
- Section 5, 15 U.S.C. § 717d (1982) 12
- Section 7(b), 15 U.S.C. § 717f(b) (1982) 11
- Section 7(c)(1)(A), 15 U.S.C. § 717f(c)(1)(A) (1982) 10
- Section 7(e), 15 U.S.C. § 717f(e) (1982) 10
- Section 19(b), 15 U.S.C. § 717r(b) (1982) 6

ADMINISTRATIVE REGULATION:

Regulation of Natural Gas Pipelines After Partial Wellhead Deregulation, 50 Fed. Reg. 52217, 52224 (1985) 13

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SUPREME COURT OF THE UNITED STATES
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No. 85-

ARKLA ENERGY RESOURCES,
a division of Arkla, Inc.
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Arkla Energy Resources ("Arkla"), a division of Arkla, Inc.,[1] seeks a writ of certiorari to review a decision of the United States Court of Appeals for the District of Columbia Circuit to the extent that decision upheld orders of the Federal Energy Regulatory Commission ("Commission") precluding the enforcement of minimum take obligations in interstate natural gas pipeline company tariffs. The effect of those orders was to alter, fundamentally and permanently, the service provided by Arkla and others under long-standing certificates of public convenience and necessity issued under the Natural Gas Act ("NGA").

[1] Arkla's petition for review was filed in the court below under the name of Arkansas Louisiana Gas Company, a division of Arkla, Inc. Following the submission of briefs, the Commission authorized the company to change the name under which it operated its facilities subject to federal regulation to Arkla Energy Resources, a division of Arkla, Inc.

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 1144 and is reproduced in the Appendix.[2] Of the five Commission orders reviewed in that opinion, three are officially reported. III Fed. Energy Guidelines (CCH) ¶¶ 30,571, 30,584, 30,607 (Order Nos. 380, 380-A and 380-C, respectively). All five orders are reproduced in the Appendix.

JURISDICTION

The judgment of the court of appeals was entered on August 20, 1985. Requests for rehearing and suggestions for rehearing *en banc* were denied October 25, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. §§ 1254(1), 2350 (1982).

STATUTES INVOLVED

The principal statutory provisions involved are NGA Sections 5 and 7, 15 U.S.C. §§ 717d, 717f (1982), relevant portions of which are reproduced in the Appendix.

STATEMENT OF THE CASE

A. Background

This petition is necessitated by a court of appeals decision that upheld Commission orders limiting the continued effectiveness of "minimum bill" provisions and precluding

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[2] The opinions of the court of appeals and the Commission are contained in the Appendix to the petition for certiorari filed by Transwestern Pipeline Company ("Transwestern") that seeks review of the same court of appeals decision. Transwestern Pipeline Co. v. FERC, No. 85-1219 (petition filed January 21, 1986). References to those opinions herein are to that Appendix, and are designated by "App. ." Arkla adopts Transwestern's Appendix as its own. In addition, Arkla has appended materials to this Petition as a supplement to that Appendix.

the enforcement of "minimum take" obligations in existing interstate natural gas pipeline tariffs. "Minimum bill" provisions are intended to assure the pipeline of a minimum revenue stream. They require that a pipeline customer pay the full tariff rate for a specified quantity of gas, either monthly or annually, whether or not the customer actually takes that minimum bill quantity. As a result, a purchaser can be billed under such a provision for gas it does not take and the pipeline is therefore not required to purchase. Failure to take the minimum bill quantity is not a breach of contract, it simply activates the minimum bill provision. Because changes in a pipeline's rates affect the potential dollar impact of the minimum bill provision, a minimum bill is closely related to a pipeline's rates.

A "minimum take" obligation, in contrast, represents a purchaser's absolute commitment to take delivery of a minimum volume of gas each day. Failure to take the specified volume constitutes a violation of the applicable certificate, tariff and contract, and the purchaser can be compelled to accept that volume. Minimum take obligations are typically included in pipeline sales contracts in order to accommodate the pipeline's need for operational stability[3] and to permit the efficient design of the pipeline's facilities.[4] Thus, a minimum take obligation is a fundamental feature of the service undertaken by the pipeline. Because the extent of a

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[3] These operational considerations are complex and vary from system to system. In many instances, pipelines receive supplies from thousands of wells spread over several states, rendering rapid regulation of system intake impossible. In addition, large portions of a pipeline's available gas supplies may be produced in conjunction with oil, causing gas availability to be subject to oil production. The need to protect certain gas reservoirs from geological damage may also necessitate a customer's agreement to purchase specified minimum volumes.

[4] For example, the pipeline is often able to avoid the construction of storage facilities that would otherwise be required to meet wide and sudden fluctuations in the purchaser's daily demand for gas.

customer's "minimum take" obligation is unaffected by rate change filings, it is not a rate provision.

Although Arkla is adversely affected by both the minimum bill and minimum take aspects of the Commission's orders, Arkla seeks Court review only of that portion of those orders which precludes enforcement of minimum take obligations.

B. The Commission's Orders

In August 1983, the Commission proposed through an exercise of its powers under NGA Section 5 to eliminate the variable cost portion[5] of minimum bill provisions in interstate pipeline tariffs. Following the receipt of comments, the Commission issued Order No. 380, which precluded pipelines from collecting through their minimum bill provisions more than the portion of the pipeline's rate attributable to fixed costs. On rehearing, the Commission claimed it had also intended its rule to preclude the enforcement of minimum take obligations. Because its original notice of proposed rulemaking had not raised this issue, the Commission requested comments on its new proposal. App. 131-33.

In Order Nos. 380-C and 380-D, the Commission applied its minimum bill rule to minimum take obligations. As a result, if a pipeline customer fails to take the minimum volume specified by contract, the pipeline can only require the customer to pay the fixed cost portion of the rate attributable to the deficient volumes. In essence, the Commission's orders have converted minimum take obligations into minimum bill provisions.

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[5] The overwhelming majority of variable costs reflected in pipeline rates are amounts paid by the pipeline to its gas suppliers. For example, in Arkla's case, those purchased gas costs represent almost 99.5% of Arkla's total variable costs.

C. The Impact on Arkla

Since 1968, Arkla has sold gas to Northwest Central Pipeline Corporation ("Northwest Central") and its predecessors under a contract containing both a minimum bill provision and a minimum take obligation. Under that agreement, Northwest Central could take as much as 132,270 Mcf per day and had a minimum take obligation of 74,593 Mcf per day. The minimum bill provision required that Northwest Central pay for an annual average of 99,457 Mcf per day, whether or not it took that volume. Performance of the contract required Arkla to construct a major extension of its facilities into Missouri for the sole purpose of making the sale. After extensive hearings, the Commission issued a certificate authorizing Arkla to perform the proposed service in accordance with the the terms of that contract. *Cities Service Gas Co.*, 38 F.P.C. 364 (1967).

At the time of Order No. 380, Arkla and Northwest Central had on file with the Commission a proposed settlement eliminating Arkla's right to recover purchased gas costs through the minimum bill provision. That settlement specifically confirmed that, under the contract and applicable certificate, Northwest Central had a daily minimum take obligation of 74,593 Mcf per day. Following the issuance of Order No. 380-A, the Commission approved the settlement. *Northwest Central Pipeline Corp.* v. *Arkansas Louisiana Gas Co.*, 28 FERC ¶ 61,211, at 61,390 (1984).

Because the Arkla-Northwest Central contract already contains a minimum bill provision, the effect of the Commission's Order Nos. 380-C and 380-D is to eliminate the minimum take provision from the contract. Arkla's maximum delivery obligation is unaffected, however. Thus, Arkla must deliver up to 132,270 Mcf on any day Northwest Central so demands, but Northwest Central has no obligation to purchase any gas. Northwest Central continues to demand full daily contract volumes whenever its system operations so

require. Since the issuance of Order No. 380-C, however, Northwest Central at other times takes at levels well below the minimum take volume.[6] The service provided by Arkla has therefore been fundamentally altered and Arkla has been precluded from rendering the type of service it agreed to provide when it accepted the certificate to sell to Northwest Central.

D. The Decision Below

The court of appeals[7] failed to distinguish between minimum take obligations and minimum bill provisions, treating the two as synonymous and referring to both as "minimum bills." *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1150 n.3 (D.C. Cir. 1985), App. 19. As a result, in responding to numerous challenges to the Commission's authority under NGA Section 5 to modify existing minimum bill provisions and minimum take obligations, the court of appeals spoke only in terms of the Commission's authority under Section 5 to modify "minimum bills."

Confining its discussion of that authority to a single footnote, the court of appeals asserted that the Commission could modify "minimum bills" under NGA Section 5 for two reasons: First, "elimination of minimum bills has no effect on the pipeline's *authorized* service . . . [and] merely addresses the *rates* the pipeline may charge its customers" and, second, NGA Section 5, by providing the Commission authority to alter the terms of existing contracts found to be "unjust and unreasonable," empowers the Commission to

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[6] For a period of time following Order No. 380-C, Northwest Central took no gas from Arkla. Now, Northwest Central generally purchases an average of 50,000 Mcf per day during the five-month winter season and 35,000 Mcf per day during the remainder of the year.

[7] Arkla petitioned for review of the Commission's orders pursuant to NGA Section 19(b), 15 U.S.C. § 717r(b) (1982).

modify "minimum bills." 770 F.2d at 1153 n.9 (emphasis in original), App. 25-26.[8]

REASONS FOR GRANTING THE WRIT

This Case Presents a Question of First Impression Critical to the Administration of the Natural Gas Act.

When attempting to give effect to its current view regarding the appropriate role of minimum take obligations, the Commission must adhere to the statutory limits placed on its authority. "Congress did not give the Commission *carte blanche* to take whatever action it might consider appropriate" in the regulation of the natural gas industry. *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256, 263 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972).

By eviscerating minimum take obligations, the Commission effected a fundamental change in Arkla's existing certificated service. Now Arkla is required to render a service it never agreed to provide.

Although the Commission has authority under NGA Section 5 to alter certain terms and conditions of service, the Commission is not given the power under that provision to alter permanently the service itself. Fundamental and permanent changes in certificated authority can be accomplished, if at all, only under NGA Section 7, which specifically addresses reductions and increases in service.

The precise scope of the Commission's authority to alter certificated service is a question of first impression and the

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[8] The only cases cited by the court of appeals in support of its conclusions involved the well-settled principle that NGA Section 5 empowers the Commission to modify rates in existing contracts and tariffs. Permian Basin Area Rate Cases, 390 U.S. 747, 783-84 (1968); Atlantic Refining Co. v. Public Service Comm'n, 360 U.S. 378, 389 (1959). These decisions do not address the Commission's authority to modify existing certificates.

source of substantial confusion within the industry. In the past, the Commission questioned its authority to make *any* unilateral changes in certificated service. Beginning with the orders below, however, the Commission has asserted, with virtually no analysis, the authority to effect such fundamental changes in existing certificates under NGA Section 5. To the extent it may be said to have addressed the issue at all, the Commission appears to have relied on an erroneous interpretation of this Court's decision in *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972). The court of appeals failed to address the issue because of its unexplained insistence on treating minimum bills and minimum take obligations as identical in substance.

If left unresolved, the uncertainty regarding the stability of existing certificates will inhibit, or substantially increase the cost of, investment in natural gas pipeline facilities. The Court should therefore exercise its *certiorari* jurisdiction to review this unprecedented invasion of existing certificates and to clarify the extent of the Commission's authority under NGA Sections 5 and 7.

A. The Commission's Minimum Take Orders Effect A Fundamental Change in Certificated Service.

The court of appeals failed to recognize that this case presents the issue of the Commission's authority to alter existing certificates. Elimination of Northwest Central's minimum take obligation, however, has clearly caused a fundamental change in the service Arkla offered, and was authorized, to provide.

Arkla agreed to make available an annual average of 99,457 Mcf per day. Northwest Central needed flexibility to take higher volumes during the winter when its heating load increased and lower volumes when its system demand dropped in the summer. In return for providing Northwest Central flexibility to swing up to 132,270 Mcf on any day,

Arkla required that Northwest Central take no less than 74,593 Mcf on any day, and designed its pipeline facilities accordingly. Absent this limitation, Arkla would have been required either to lower the maximum volume that could be taken under the contract or to design Arkla's pipeline system and gas purchase arrangements in a way that accommodated the wide swings otherwise possible under the agreement.

Precluded by the Commission's orders from enforcing Northwest Central's minimum take obligation, Arkla is now required to provide a substantially different kind of service. Viewed from one perspective, Arkla's service obligation has been reduced to a type of peaking[9] service available at Northwest Central's demand. From another perspective, Arkla's obligations have been enlarged, requiring it to accommodate swings in demand far greater than those to which it committed.[10] Under either view, the service originally agreed to when Arkla accepted its certificate has been fundamentally altered.

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[9] A peaking service is intended to accommodate wide fluctuations in a customer's demand generally related to sharply increased requirements during cold weather. Peaking service is generally more expensive because the capacity required to meet peak demands remains idle for considerable portions of the year. In contrast, baseload service, such as Arkla agreed to provide Northwest Central, affords the customer with a steady level of service throughout the year, which is deliverable at lower per unit costs because pipeline capacity is more fully utilized. Not only do these differences in service affect how a pipeline is designed and built, but they also compel different gas acquisition policies.

[10] The Commission's orders have also affected the reliability of Arkla's service and impaired Arkla's ability to manage its gas supply in a rational manner. For example, Northwest Central sharply increases its demands for gas at times of peak winter demand on Arkla's system. Because Arkla's purchases cannot be increased and moved to market fast enough to meet these peak demands, Arkla has been required to curtail deliveries to several customers, including Northwest Central. This problem did not arise when Northwest Central adhered to the more narrow range of variations in demand permitted when the minimum take obligation was in effect.

The delivery and take obligations under a gas sales contract are at the core of the contract between the parties and, thus, central to the service certificated by the Commission. The court below was wrong, therefore, in concluding that the elimination of one such core obligation had no effect on authorized service.[11]

B. NGA Section 5 Does Not Authorize Fundamental Changes in Existing Certificates.

The Commission's attempt to eliminate minimum take obligations through the exercise of its NGA Section 5 authority is unlawful. That Section's authorization to change terms and conditions of service if they are "unjust and unreasonable," does not extend to fundamental and permanent changes in existing certificates. Such alterations of the fundamental character of certificated service, particularly when that change transforms the transaction into a wholly new type of service, can be accomplished, if at all, only under NGA Section 7.

Section 7 is the only portion of the NGA that authorizes enlargements or reductions in certificated service. Before jurisdictional service can be enlarged, the Commission must issue a certificate authorizing the expanded service. NGA Section 7(c)(1)(A), 15 U.S.C. § 717f(c)(1)(A) (1982). The Commission must find that the pipeline is "willing and able" to provide the service and may attach conditions to its authorization to assure that any new service will meet the "public convenience and necessity." NGA Section 7(e), 15

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[11] The court below also erred in suggesting that minimum take obligations only affect pipeline rates. Wisconsin Gas Co. v. FERC, 770 F.2d 1144, 1153 n.9 (D.C. Cir. 1985), App. 25-26. Minimum take obligations, as distinguished from minimum bill provisions, are not rate-related. Minimum take obligations require that a customer take a specific volume. No money is paid for gas not taken and there is no argument that the purchaser may be required to pay more than a just and reasonable rate for the gas it purchases.

U.S.C. § 717f(e) (1982). Nevertheless, the Commission may not compel a company to render service on terms the company finds unacceptable. Even though it may have been "willing and able" to perform the service it proposed, the company may reject the certificate as conditioned by the Commission and decline to provide the service. *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 387-88 (1959).

Once a certificate has been accepted and service has commenced, the company may not alter or abandon that service without the prior approval of the Commission. NGA Section 7(b), 15 U.S.C. § 717f(b)(1982). Permanent reductions in delivery and take obligations represent significant alterations of certificated service and can only be accomplished under NGA Section 7(b). *Reynolds Metals Co.* v. *FPC*, 534 F.2d 379, 384 (D.C. Cir. 1976).

The purpose of NGA Section 7 would be undermined if, once certificated, service could be transfigured under NGA Section 5 without reference to the standards of NGA Section 7. The Commission would be relieved of its obligation to find that the service is consistent with the "public convenience and necessity" and to find the company "willing and able" to perform the service as modified.[12]

The court below failed to address these issues. Whatever the validity of its conclusion that minimum bill provisions can be altered under NGA Section 5, that conclusion cannot be extended to minimum take obligations.

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[12] The rulemaking procedures utilized by the Commission in the orders under review are not appropriate for NGA Section 7 actions. The Administrative Procedure Act ("APA") provides that proceedings affecting licenses are adjudications and generally subject to the same statutory safeguards provided for in other formal adjudicatory proceedings. 5 U.S.C. §§ 551(7), 551(8), 558(c) (1982). Certificates issued under the NGA are licenses within the meaning of the APA. 5 U.S.C. § 551(9) (1982). These provisions of the APA are reproduced in the Appendix to this Petition.

Although the Commission did not directly address the impact of its minimum take orders on existing certificates, it appears to have relied on this Court's opinion in *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972) ("*LP&L*"), as authority for its action. App. 135, 248-49. The *LP&L* case, however, involved the Commission's utilization of NGA Section 4, 15 U.S.C. § 717c (1982), not NGA Section 5, 15 U.S.C. § 717(d) (1982). 406 U.S. at 644. Furthermore, in *LP&L* the Court was addressing changes in curtailment provisions to be applied during a "temporary" nationwide natural gas shortage. *Id.* at 626. *LP&L* did not involve permanent alterations of certificated service, which can be accomplished, if at all, only under NGA Section 7. *Reynolds Metals Co.* v. *FPC*, 534 F.2d 379, 384 (D.C. Cir. 1976); *Michigan Power Co.* v. *FPC*, 494 F.2d 1140, 1144 (D.C. Cir. 1974)(distinguishing *LP&L*).

In Order No. 380-A, the Commission also asserted with respect to its minimum bill orders that it had the "authority to alter the terms and conditions of certificated service even though the affected parties, acting alone, could not have changed them." App. 135. The Commission does have the authority under NGA Section 5 to alter terms and conditions that the pipeline could not alter under NGA Section 4 because of contractual limitations. *Compare FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) *with United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956). There is no precedent, however, in support of the proposition that the Commission, acting under NGA Section 5, may alter terms and conditions that a pipeline could only alter under NGA Section 7. Permanent and significant changes in certificated service can be accomplished, if at all, only under the procedures and standards of NGA Section 7.

C. Resolution of the Commission's Authority to Modify Existing Certificates is Necessary to End Industry Confusion that Jeopardizes Future Financing of Pipeline Facilities.

The scope of the Commission's authority under the NGA to alter certificated service permanently has never been before this Court. As discussed above, however, the NGA does not explicitly provide such authority. In the context of other statutes that did not explicitly confer authority to upset existing certificates, this Court has refused to imply any such authority. *United States* v. *Seatrain Lines, Inc.*, 329 U.S. 424, 429-32 (1947); *CAB* v. *Delta Air Lines, Inc.* 367 U.S. 316, 322-25 (1961).

Until recently, the Commission had never asserted any authority to modify existing certificate obligations permanently. Indeed, not long before the issuance of Order No. 380, one of the Commission's law judges concluded that the Commission lacked the authority unilaterally to revoke, suspend or adversely modify existing certificates. *Trunkline LNG Co.*, 22 FERC ¶ 63,028, at 65,135-39, *aff'd*, 22 FERC ¶ 61,245 (1983). Although finding that determination "scholarly and well-reasoned," the Commission found it did not need to reach this "difficult question." 22 FERC ¶ 61,245, at 61,442. With virtually no discussion, however, the Commission in Order No. 380-C directed the eradication of minimum take obligations. App. at 248-49. More recently, the Commission has asserted the power under NGA Section 5 unilaterally to order changes in the contract demand volumes in existing certificates. *Regulation of Natural Gas Pipelines after Partial Wellhead Deregulation*, 50 Fed. Reg. 52217, 52224 (1985). As previously discussed, this recent attempt to expand the Commission's authority appears to be based on an erroneous interpretation of this Court's *LP&L* decision.

The importance to the industry of resolving the scope of the Commission's authority is manifest. The law judge in *Trunkline*, following an extensive hearing, succinctly explained the problem as follows:

> [M]assive investments must be and are made to construct facilities in reliance on the conditions and permanence for the prescribed term of the certificates issued by the Commission. Without . . . security, businessmen and investment institutions would not enter into such projects nor lend the necessary funds to make the projects possible. The record in this case leaves absolutely no doubt that investment funds will *not* be available if certificates, in the absence of violations, can be revoked by the granting agency at will for political or other reasons such as supply changes, pricing, etc.

22 FERC ¶ 63,028, at 65,138 (emphasis in original). On Commission review, two commissioners argued for a clear finding that the Commission does not possess the authority to "unilaterally modify or revoke a Section 7 certificate." 22 FERC at 61,445. The purpose of this plea was to avoid the chilling effect of regulatory uncertainty on investment in natural gas facilities. *Id.* Absent the Court's resolution of this uncertainty, that chilling effect will remain a formidable deterrent to pipeline financing, to the ultimate detriment of natural gas consumers throughout the nation.

CONCLUSION

For the reasons set forth above, this Court should issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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January 23, 1986

APPENDIX

ADMINISTRATIVE PROCEDURE ACT

§ 2, 5 U.S.C. § 551 (1982)

* * * * * *

(7) "adjudication" means agency process for the formulation of an order;

(8) "license" includes the whole or a part of an agency permit, certificate, approval, registration, charter, membership, statutory exemption or other form of permission;

(9) "licensing" includes agency process respecting the grant, renewal, denial, revocation, suspension, annulment, withdrawal, limitation, amendment, modification, or conditioning of a license;

§ 9, 5 U.S.C. § 558 (1982)

* * * * * *

(c) When application is made for a license required by law, the agency, with due regard for the rights and privileges of all the interested parties or adversely affected persons and within a reasonable time, shall set and complete proceedings required to be conducted in accordance with sections 556 and 557 of this title or other proceedings required by law and shall make its decision. Except in cases of willfulness or those in which public health, interest, or safety requires otherwise, the withdrawal, suspension, revocation, or annulment of a license is lawful only if, before the institution of agency proceedings therefor, the licensee has been given:

(1) notice by the agency in writing of the facts or conduct which may warrant the action; and

(2) opportunity to demonstrate or achieve compliance with all lawful requirements.

When the licensee has made timely and sufficient application for a renewal or a new license in accordance with agency rules, a license with reference to an activity of a continuing nature does not expire until the application has been finally determined by the agency.

Supreme Court, U.S.
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Nos. 85-1219, *et al.*

85-1236 (6)
85-1237 (6)
85-1250 (7)
85-1252 (8)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY AND MIDWESTERN GAS TRANSMISSION COMPANY IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

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February 10, 1986

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

List Of Affiliates Of Tennessee Gas Pipeline Company And Midwestern Gas Transmission Company Who Are Not *Wholly Owned By Tenneco Inc. Pursuant To Rule 28.1*

Adela Investment Company S.A.
Akulu Marchon (PTY) Ltd.
Akulu Chemicals (PTY) Ltd.
Albright, Morarji and Pandit Limited
Albright & Wilson (Australia) Ltd.
Albright & Wilson Match Phosphorous Co. Ltd.
Arndale Fuels Ltd.
Bracey Petroleum Products Ltd.
Butler Oil Products Ltd.
Case Poclain GmbH & Co.
Collins Pipeline Company
Depositas Del Norte, S.A.
FC Marine Inc.
Gardinol Products (PTY), Ltd.
HT Gathering Company
Intertractor Viehmann GmbH & Co.
J.I. Case do Brasil & Cia..
Kern Island Water Company
Kern River Canal and Irrigating Company
Kern River Gas Transmission Company
Losenhausen Maschinenbau AG & Co.
Losenhausen Maschinenbau AG
Marchon-Paragon Holdings (PTY) Limited
Marchon-Paragon Sulphonation (Cape) (PTY) Ltd.
Marchon-Paragon Sulphonation (PTY) Ltd.
Mistal Inc.
Monroe Auto Pecas S.A.
National Brands (PTY), Ltd.

Omni-Pac GmbH
P.P.M. Guindastes Hidraulicos S.A.
Pholyphosphates Inc.
Poclain S.A.
S.A. Paper Chemicals (Proprietary), Limited
Sara Gretes Cafetria AB
Skogstre A/S
Stoco Mutual Water and Sewer Company
T & M Terminal Company
Tees Storage Company Limited
Tenneco Insurance Ventures Inc.
Tenneco Oil Company of Nigeria Unlimited
Tenneco Oil of Nigeria Unlimited
Tenngasco Gas Gathering Company
Tess Storage Company Limited
TENN-USS Chemicals Finance Corporation
Tractortechnic Canada, Ltd.
Universal Chemical Contractors (PTY)
Vibromax France SARL
Vibromax France SCI
W.R. John & Company (Rumney) Ltd.

TABLE OF CONTENTS

	Page
REASONS FOR GRANTING THE WRIT	3
I. FERC Has Destroyed The Basic Contractual Underpinnings Of The Natural Gas Industry Without Satisfying The Requirements For Such Contractual Abrogation Set Forth In This Court's Decisions	4
II. The Court Below Erred In Affirming A Rule Which Restructured The Natural Gas Industry But Failed To Resolve The Linked Impact Of Its Actions On Take-Or-Pay	7
CONCLUSION	9

TABLE OF AUTHORITIES

CASES: Page

Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981) 4

FCC v. RCA Communications, 346 U.S. 86 (1953) 6

In Re Permian Basin Area Rate Cases, 390 U.S. 747 (1968) 4

Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961) 4

United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) 4

U.S. v. El Paso Natural Gas Co., 376 U.S. 651 (1964) 4

STATUTES:

Natural Gas Act,
15 U.S.C. § 717 et. seq. 4
Section 4, 15 U.S.C. § 717c 6
Section 5, 15 U.S.C. § 717d 6

IN THE

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Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF OF RESPONDENTS TENNESSEE GAS PIPELINE COMPANY AND MIDWESTERN GAS TRANSMISSION COMPANY IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

Tennessee Gas Pipeline Company (Tennessee) and Midwestern Gas Transmission Company (Midwestern)[1]

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[1]Tennessee and Midwestern were parties to the proceeding below. They are natural gas pipeline companies engaged primarily in the business of purchasing, transporting and selling

support the petitions for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit filed by Transwestern Pipeline Company (No. 85-1219), ANR Pipeline Company (No. 85-1236), Texas Eastern Transmission Corporation (No. 85-1237), Trunkline Gas Company and Panhandle Eastern Pipe Line Company (No. 85-1250), and Arkla Energy Resources (No. 85-1282). These petitions challenged a decision of the United States Court of Appeals for the District of Columbia Circuit (App. A-1)[2] upholding a series of rulemaking orders of the Federal Energy Regulatory Commission (Commission or FERC) that declared unlawful longstanding and previously authorized minimum contractual purchase

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natural gas in interstate commerce under authority granted by and subject to the jurisdiction of the Commission under the Natural Gas Act. Tennessee's main transmission system extends northeastward from its supply sources in Texas, Louisiana and the Gulf of Mexico into sixteen states terminating in New England. Its sales are made to gas distribution companies and other pipelines which resell the gas being ultimately consumed in twenty-two states, primarily in the Middle Atlantic, Midwest and New England regions. At the end of 1983, Tennessee had over three billion dollars of utility plant in service, including almost fourteen thousand total miles of pipeline. Midwestern has two separate pipeline systems. Midwestern's Southern System extends from Portland, Tennessee, where it purchases its gas supply from its affiliate, Tennessee, to Joliet, Illinois. It sells primarily to gas distributors who resell the gas in the greater Chicago-Gary area. Its Northern System buys natural gas from a Canadian supplier, and its principal customer is ANR Pipeline Company, which primarily serves the states of Wisconsin and Michigan. At the end of 1983, Midwestern had about one-hundred sixty million dollars of utility plant in service, including over nine hundred miles of pipeline.

[2]The appendix references are to the appendix filed with this Court by Transwestern.

commitments by pipeline customers that enabled the recovery of variable costs through minimum commodity bills.[3] In the interests of brevity, Tennessee and Midwestern hereby adopt the statements of the case, statutes involved, jurisdiction and opinions below submitted in the petition of Trunkline Gas Company and Panhandle Eastern Pipe Line Company.[4]

REASONS FOR GRANTING THE WRIT

This case involves fundamental and important questions concerning the Commission's authority to release partial requirements customers of pipelines from previously authorized and longstanding minimum purchase commitments while at the same time holding pipelines to their contractual agreement to provide certain maximum volumes to those customers upon demand. The case is not only vitally important to pipelines because they have made multi-million dollar investments in facilities and have entered into minimum gas purchase obligations with producers and suppliers in reliance on the contract provisions that have been set aside, but also to the pipelines' entire requirements customers who will have to bear a much greater portion of cost of service of the pipeline.

I.

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[3]These orders were issued in Commission Docket No. RM83-71 and are identified as Order No. 380 (App. A-71), 380-A (App. A-129), 380-B (App. A-226), 380-C (App. A-231), and 380-D (App. A-271).

[4]The issues addressed here relate to questions presented for review by Transwestern Pipeline Company and Texas Eastern Transmission Corporation.

FERC HAS DESTROYED THE BASIC CONTRACTUAL UNDERPINNINGS OF THE NATURAL GAS INDUSTRY WITHOUT SATISFYING THE REQUIREMENTS FOR SUCH CONTRACTUAL ABROGATION SET FORTH IN THIS COURT'S DECISIONS

Over the last thirty years in cases under the Natural Gas Act (15 U.S.C. § 717, *et seq.*), this Court has repeatedly recognized the importance of private contracts between interstate pipelines and their customers and has held that such contracts may be abrogated "only in circumstances of unequivocal public necessity." *In Re Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968), *citing United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *accord Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 582 (1981). The basis for this heavy burden was that "preserving the integrity of contracts . . . permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry." *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. at 344; *see also U.S.* v. *El Paso Natural Gas Co.*, 376 U.S. 651, 660 (1964) ("pipelines are very expensive; and to be justified they need long-term contracts for sale of gas that will travel them"); *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 334 (1962) ("in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest. . . . The compelling validity of such considerations has been recognized fully in the natural gas public utility field.").

The court below did not determine whether the Commission's action abrogating these private con-

tracts met this Court's standard of "unequivocal public necessity." Thus, it requires review by this Court to determine whether contract provisions such as these can be abrogated under the Commission's rule without meeting this standard.

Review is further warranted because the Commission abrogated these contracts, notwithstanding the reliance placed on such contracts by interstate pipelines, such as Tennessee and Midwestern. It cannot be disputed that minimum commodity bills were essential parts of gas supply contracts entered into between interstate pipelines and their customers. In the case of Tennessee and Midwestern, the bargain struck with their partial requirements customers was that Tennessee and Midwestern would provide those customers with a specified firm volume of gas upon demand and the customers' payments would be subject to a minimum commodity bill based on $66^{2}/_{3}\%$ of the monthly volume they were entitled to demand. In this way, the partial requirements customer, which is a reseller of gas and closer to the ultimate market than Tennessee and Midwestern, shared in the risk of market fluctuations.

Based on these agreements, Tennessee and Midwestern undertook the multi-million dollar investments necessary to meet those customers' requirements. Tennessee entered into supply contracts with producers which also contained minimum take-or-pay obligations, and Midwestern undertook minimum bill obligations to its suppliers. These bargained-for minimum commodity bill provisions, which have been in Tennessee's and Midwestern's contracts and tariffs from the inception of service to such customers, were found to be required by the public con-

venience and necessity when the service to the customer was first certificated and have time and time again in numerous rate proceedings been a part of the tariff provisions that were approved as just and reasonable under the standards of Sections 4 and 5 of the Natural Gas Act. The Commission's elimination of the minimum commodity bills penalizes pipelines, such as Tennessee and Midwestern, for that reliance and effects an after-the-fact change in the governing rules.

Furthermore, in support of this abrogation of these longstanding contracts, the Commission's basic thesis accepted by the court below involved generalized statements of the benefits of competition.[5] The Commission made no attempt to show "unequivocal public necessity" as required by this Court (App. A-81, A-100), nor did the court below require such a finding (App. A-18).

The D.C. Circuit's acceptance of the Commission's general assertions of the benefits of competition is squarely contrary to *FCC* v. *RCA Communications*, 346 U.S. 86, 94 (1953) where this Court rejected a like order based on the mere recitation, without thorough study, that competition may have beneficial effects.

Therefore, the petitions should be granted because the court below ignored longstanding decisions of this Court which require a finding of "unequivocal public

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[5]The Commission performed no studies to support its findings. The Commission relied for the most part on general comments submitted by partial requirements customers of interstate pipelines who supported the Commission's proposal (*see* e.g. App. A-88 n. 28).

necessity" before the private contracts at issue here can be abrogated.

II.

THE COURT BELOW ERRED IN AFFIRMING A RULE WHICH RESTRUCTURED THE NATURAL GAS INDUSTRY BUT FAILED TO RESOLVE THE LINKED IMPACT OF ITS ACTIONS ON TAKE-OR-PAY

As the court below recognized, the Commission cannot issue a rule such as this without also resolving inextricably linked issues (App. A-38). Where the court erred, though, was in not recognizing that take-or-pay provisions between producers and interstate pipelines are inextricably linked with minimum commodity bills that exist between interstate pipelines and their customers.

It is clear that, in reliance on their sales contracts which contained minimum commodity bills recovering variable costs, pipelines in turn contracted for gas supplies from producers. These supply contracts typically include take-or-pay provisions which are similar in nature to the minimum commodity bills that were the subject of the Commission's rule. While it could not be disputed below that the same policy considerations could support elimination of these counterpart take-or-pay and minimum bill provisions alike, the court, as did the agency below, refused to require concurrent resolution of these inextricably related matters (App. A. 39-40). In thus failing "to come to grips with the pipeline's take-or-pay obligations at the supply end of the pipeline system while eliminating the counterpart purchase obligations owing to

the pipeline at the opposite end of the pipeline system, the pipeline has been arbitrarily stripped of its right to contract with its purchasers in a way that corresponds with its purchase obligations to its suppliers.

If a more competitive marketplace is the *raison d'etre* below, then it must be recognized that in a truly competitive marketplace a customer could not expect its pipeline supplier to undertake massive gas supply commitments when, on the other hand, it could be relieved of its corresponding purchase obiigations to the pipeline. Ironically, only regulation would have it so. But regulation must be a two way street, and the pipeline must likewise be relieved of its corresponding purchase obligations.

This lack of evenhanded treatment of these mutual, balanced seller-purchaser relationships which coexist at each end of the pipeline results in additional costs being borne by the pipeline and by its full requirements customers that have no alternative sources of supply. Thus, the take-or-pay and minimum commodity bill issues are inextricably linked as demonstrated by the substantial take-or-pay cost consequences that result if variable costs are not recovered in minimum commodity bills.

Review by this Court is therefore warranted because of the failure by the court below to recognize the inextricable link between take-or-pay and the recovery of variable costs in minimum commodity bills and to therefore, require the Commission to resolve the take-or-pay issue concurrently with the minimum bill issue.

CONCLUSION

For the reasons set forth above, this Court should issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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Nos. 85-1219 & 85-1252

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

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Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

ARKLA ENERGY RESOURCES,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENT TEXAS GAS TRANSMISSION CORPORATION IN SUPPORT OF THE PETITIONERS

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether section 5 of the Natural Gas Act permits the Federal Energy Regulatory Commission to revoke or modify longstanding certificates of public convenience and necessity, issued under section 7 of the Act, by forbidding enforcement of contractual provisions for minimum commodity bills or minimum purchase obligations that are incorporated in those certificates.*

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* The parent companies and affiliates of respondent Texas Gas Transmission Corporation are listed in Appendix A, *infra*.

TABLE OF CONTENTS

	Page
STATEMENT	1
ARGUMENT	5
CONCLUSION	8

TABLE OF AUTHORITIES

CASES:

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959)	7
Atlantic Seaboard Corp., 11 FPC 43 (1952)	3
CAB v. Delta Air Lines, 367 U.S. 316 (1961)	6
Trunkline LNG Co., 22 FERC ¶ 63,028, *aff'd*, 22 FERC ¶ 61,245 (1983)	6
United States v. Seatrain Lines, Inc., 329 U.S. 424 (1947)	5, 6

STATUTES:

15 U.S.C. § 717d	*passim*
15 U.S.C. § 717f	*passim*

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1219

TRANSWESTERN PIPELINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

No. 85-1252

ARKLA ENERGY RESOURCES,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF OF RESPONDENT TEXAS GAS TRANSMISSION CORPORATION IN SUPPORT OF THE PETITIONERS

STATEMENT

Respondent Texas Gas Transmission Corporation ("Texas Gas") operates an interstate pipeline for the transportation of natural gas under certificates of public convenience and necessity issued by the Federal Energy

Regulatory Commission ("FERC") and its predecessor, the Federal Power Commission ("FPC"), pursuant to section 7 of the Natural Gas Act of 1938 ("NGA"), 15 U.S.C. § 717f. The certificates at issue in this case make express reference to and incorporate specific contracts with provisions for minimum commodity bills that assure Texas Gas a minimum volume of sales. R. 496.[1] This assurance was a fundamental condition of Texas Gas's application for and acceptance of the certificates. R. 494, 1123.

In the administrative proceeding below, the FERC determined that all minimum commodity bills, even including those incorporated in a pipeline company's certificated authority, are "unjust" and "unreasonable" within the meaning of section 5 of the NGA, 15 U.S.C. § 717d. This determination will have a particularly adverse effect on Texas Gas. Approximately one-half of Texas Gas's total sales are made pursuant to contracts with "partial requirements" customers that have many alternative sources of supply. R. 493-96. Because these customers are located at the terminus of Texas Gas's interstate pipeline system, the preponderance of Texas Gas's investment in pipeline facilities necessarily was incurred to render service under these contracts. R. 484-85. Before the FERC ruled, these contracts prescribed roughly symmetrical obligations: Texas Gas had a firm obligation to deliver up to 100 percent of the contract amount, and the purchaser had a stated minimum obligation to buy at least 75 percent of that amount. The FERC's order destroys this symmetry. Without the assurance of minimum sales volumes to these customers, "50% of [Texas Gas's] market can swing from zero to 100% of contract demand." R. 496.

The FERC's order therefore goes to the very core of the nature of Texas Gas's contractual undertakings. Whereas Texas Gas previously was a supplier of baseload

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[1] "R." refers to the joint appendix in the court of appeals.

service, its partial requirements customers now may unilaterally relegate it to the role of a supplier of peaking service only. The agency historically has recognized a clear distinction between baseload and peaking service:

> A pipeline would not normally be built to supply peak service, that is to say, service on the peak days only. . . . [P]ipelines are built to supply service not only on the few peak days but on all days throughout the year. In proving the economic feasibility of the project in certificate proceedings, reliance is placed upon the annual as well as the peak deliveries. Stated another way, the capital outlay for the pipeline facility is made—and justified—not only for service on the peak days but for service throughout the year.

Atlantic Seaboard Corp., 11 FPC 43, 54 (1952). The differences between baseload and peaking service affect not only the design of and investment in the pipeline but also the nature of the gas purchase contracts entered into by the pipeline to support such service. *See* Pet. 9 n. 9 (No. 85-1252).

Texas Gas's sudden demotion from a baseload to a peaking service supplier makes rational planning impossible and has serious economic implications. As a result of the FERC's order the majority of Texas Gas's partial requirements customers have reduced their purchases to levels far below the 75 percent minimum required by contract. This puts Texas Gas on the horns of a dilemma. Either Texas Gas must arrange for a decrease in the volumes it is committed to purchase under its supply contracts, thereby subjecting its full requirements customers to the likely curtailment of deliveries in the event that they demand full contract quantities; or Texas Gas must continue in force its existing contracts with producers and face the risk of very substantial liability resulting from its inability to purchase at the minimum levels required by the take-or-pay provisions

in such contracts, costs which may be borne by its full requirements customers. R. 495-96.[2] If Texas Gas had known that it was being certified to perform a service which its partial requirements customers could convert unilaterally to peaking only, or that its certificate was subject to modification to that effect, it would not have accepted the certificate and would not have made the substantial investment that was required in order to construct its pipeline and to perform its certificated base-load service. R. 1123. After making this investment and after entering long-term contracts for the supplies necessary to provide this service, Texas Gas has had its market unfairly and unexpectedly truncated by regulatory fiat.

There is no countervailing public benefit. Texas Gas is a low-cost supplier. R. 1109. But its partial requirements customers are other interstate pipelines that also acquire natural gas directly from producers. As a direct consequence of the FERC's order, "lower-cost purchases from Texas Gas have been cut back as a result of a pipeline customer's attempt to meet its take-or-pay minimums for higher cost producer supplies." R. 1110. The FERC's order, in other words, has the irrational result, at least in Texas Gas's instance, of diverting purchases from low-cost to high-cost supliers.

On petition for reivew before the court of appeals, Texas Gas contended that the FERC's order constituted an impermissible revocation or modification of its certificated authority. The court brushed this contention aside in a footnote:

> Section 7, which vests in the Commission control over the conditions under which gas may initially be dedicated to public use, does not guarantee that the

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[2] Take-or-pay provisions in contracts with producers, even though they are the functional equivalent of pipelines' minimum commodity bills, are not affected by the FERC's order. Pet. App. A-37 to A-40 (No. 85-1219).

> initial terms of that service will never change. *See* Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a section 5 proceeding, the elimination of minimum bills has no affect on the pipeline's *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5.

Pet. App. A-25 n.9 (No. 85-1219) (emphasis in original).

ARGUMENT

By permitting the effective revocation or modification of certificated authority, the decision below establishes an unfortunate precedent that will discourage pipeline companies and their investors from undertaking certificated service in the future. The decision misconstrues the proper relationship between sections 5 and 7 of the NGA and is inconsistent in principle with *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947). The Court should grant certiorari to review this important case.

1. Natural gas pipelines are very expensive and highly capital-intensive undertakings. Once constructed, the physcal equipment—the pipeline itself—cannot be converted to other uses. Interstate pipelines are not built on speculation. They are built to service identified markets and customers in accordance with specific long-term contractual arrangements. They are built and operated, moreover, in accordance with certificates of public convenience and necessity, issued by the FERC pursuant to section 7 of the NGA, that confirm the nature and scope of the service to be performed.

In applying for a certificate, a pipeline company is required to specify the essential elements of the service it is willing to perform, and its decision to accept a certificate depends upon receipt of authority to perform those essential elements of service. Thus, a company

which specifies that it is applying for authority to perform baseload service may refuse to accept a certificate that would give its customers the unilateral option of converting to peaking service. In this way, the company can be assured at the outset that the nature and scope of the service to be performed will support the required level of investment in facilities, personnel, and long-term purchase commitments.

If the pipeline company's certificated authority were subject to involuntary revocation or modification by the FERC, the necessary degree of assurance would be lacking:

> massive investments must be and are made to construct facilities in reliance on the conditions and permanence for the prescribed term of the certificates issued by the Commission. Without such security, businessmen and investment institutions would not enter into such projects nor lend the necessary funds to make the projects possible.

Trunkline LNG Co., 22 FERC ¶ 63,028 at 65,138, *aff'd*, 22 FERC ¶ 61,245 (1983). It has long been understood that the NGA provides the necessary assurance to pipeline companies and investors. Section 7, which governs the issuance of certificates, makes no provision for revocation or modification by the FERC except upon the request of the carrier itself. Almost forty years ago this Court held in *Seatrain Lines*, 329 U.S. at 429-32, that a certificate of public convenience and necessity may not be modified or revoked in the absence of express statutory authority. *See also CAB v. Delta Air Lines*, 367 U.S. 316, 321-25 (1961). Congress, in order to induce and protect investments in interstate pipelines, has never amended the NGA to provide such authority.

The decision below radically alters the statutory scheme. It permits the FERC, in the guise of exercising control over the justness and reasonableness of rates under section 5 of the NGA, actually to revoke or modify the essential elements of service incorporated in a certifi-

cate. The FERC's exercise of this novel power in this case unfairly defeats the settled expectations of pipeline companies and investors and introduces a damaging element of uncertainty into all future interstate pipeline undertakings.

Further, the FERC's order defeats the regulatory objective of reliable service. A hallmark of the NGA is its requirement that service be provided not at the lowest rate possible but at the lowest rate "consistent with the maintenance of adequate service in the public interest". *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959). By granting partial requirements customers the unilateral option of swinging from baseload service to peaking service, the FERC has impaired the ability of pipeline companies to maintain adequate service. In the absence of assurance that purchases will be maintained at a minimum level, it is impossible for a company to determine from year to year what level of service its partial requirements customers will demand. R. 475-79, 496. Accordingly, pipeline companies are placed in a position of having either inadequate supplies under contract, with consequent curtailment of service to all customers, or a surplus of supply, with attendant take-or-pay costs borne by full requirements customers.

2. The court of appeals justified this result on the ground that minimum commodity bills and minimum take provisions are "rates" that the FERC can change under section 5 even when they are incorporated in a pipeline company's certificated authority. But minimum commodity bills and minimum take provisions are not "rates." By defining the service obligation by reference to a minimum volume of natural gas, such provisions go to the essential nature of the service—baseload rather than peaking—and not merely to the price at which that service will be furnished. If the FERC had confined its attention simply to "rates," Texas Gas, as a low-cost supplier, would have had no complaint. The heart of

the problem is that the FERC has relieved Texas Gas's customers of their obligation to pay for a minimum volume of gas at any price.

To be sure, section 5 gives the FERC authority not only over "rates" but also over any "charge, classification, rule, regulation, practice or contract." Those very general statutory terms could be construed to cover each and every feature of certificated authority. But to construe section 5 expansively, as the court below has done, would allow the FERC to invalidate in its entirety a contract that defined the scope of certificated authority and thereby completely destroy the integrity of the certificate issued under section 7.

By omitting any provision for involuntary revocation or modification in section 7, Congress clearly evidenced its intention to protect the pipeline company against this type of involuntary and fundamental change in the nature and scope of its certificated service. The court below seriously erred in construing section 5 in a manner that fails to harmonize with the objectives of section 7. Section 5 should not be read to authorize involuntary changes in essential elements of certificated service.

CONCLUSION

The petitions for writs of certiorari should be granted.

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APPENDIX A

Texas Gas Transmission Corporation is wholly owned by Texas Gas Resources Corporation, which in turn is wholly owned by CSX Corporation.

CSX Corporation owns partial interests in the following subsidiaries:

Atlanta and West Point Railroad Company
The Baltimore and Ohio Railroad Company
The Baltimore and Philadelphia Railroad Company
Chicago South Shore and South Bend Railroad
The Cleveland Terminal and Valley Railroad Company
Dayton and Michigan Railroad Company
Dayton and Union Railroad Company
Eastern Hardwoods, Inc.
Fruit Growers Express Company
James Center Development Company
Littleton Fuel Company
Louisville, Henderson & St. Louis Railway Company
Mid Allegheny Corporaton
Monon Coal Company, Inc.
Nashville & Decatur Railroad Company
New Ganly Coal Corporation
North Charleston Terminal Company
Richmond, Fredericksburg and Potomac Railroad Company
Richmond-Washington Company

Neither Texas Gas Transmission Corporation nor Texas Gas Resources Corporation owns a partial interest in any subsidiary.

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v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (the "Commission") has authority under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), to regulate and modify the rates charged by natural gas pipelines under minimum commodity bill provisions included in tariffs on file with the Commission.
2. Whether the court of appeals acted correctly in upholding the decision of the Commission to order the elimination of all variable costs from the rates charged under minimum commodity bills.
3. Whether the Commission may modify the rate provisions of tariffs on file with it on the basis of a record compiled in an informal rulemaking proceeding.

STATEMENT PURSUANT TO RULE 28.1

Northern Illinois Gas Company is a subsidiary of NICOR Inc., a publicly-held company. NICOR Inc. is not affiliated with any companies other than its wholly-owned subsidiaries.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
STATEMENT	2
REASONS FOR DENYING THE PETITIONS	9
CONCLUSION	21

TABLE OF AUTHORITIES

JUDICIAL DECISIONS: Page

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959) 12
Atlantic Seaboard Corp. v. F.P.C., 404 F.2d 1268 (D.C. Cir. 1968) 15
Columbia Gas Transmission Corp. v. F.E.R.C., 628 F.2d 578 (D.C. Cir. 1979) 3
F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944) 16
F.P.C. v. Louisiana Power and Light Co., 406 U.S. 621 (1972) 14
F.P.C. v. Natural Gas Pipeline Co., 315 U.S. 575 (1942) 15
F.P.C. v. Sierra Pacific Power Co., 350 U.S. 348 (1956) 12
Lynchburg Gas Co. v. F.P.C., 336 F.2d 942 (D.C. Cir. 1964) 15
Mississippi River Transmission Corp. v. F.E.R.C., 759 F.2d 945 (D.C. Cir. 1985) 15
Mobil Oil Corp. v. F.P.C., 417 U.S. 283 (1974) 11
Northern Natural Gas Co. v. F.P.C., 399 F.2d 953 (D.C. Cir. 1968) 15
Otter Tail Power Co. v. United States, 410 U.S. 366 (1973) 15
Permian Basin Area Rate Cases, 390 U.S. 747 (1968) ..... *passim*
Phillips Petroleum Co. v. F.P.C., 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974) 18
SEC v. Chenery Corp., 332 U.S. 194 (1947) 18
Tenneco Oil Co. v. F.E.R.C., 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1979) 18
United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) 12, 14
United States v. El Paso Natural Gas Company, 376 U.S. 651 (1964) 14
United States v. Florida East Coast Ry. Co., 410 U.S. 224 (1973) 18, 20

TABLE OF AUTHORITIES—Continued

Page

United States v. Seatrain Lines, Inc., 329 U.S. 424 (1947) 12
Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978) ..... *passim*

ADMINISTRATIVE DECISIONS:

Tennessee Gas Pipeline Co., 32 F.E.R.C. ¶ 61,311 (1985) 19
Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985) 19

STATUTES:

Department of Energy Organization Act

Section 403(c), 42 U.S.C. § 7173(c) (1984) 17, 20

Natural Gas Act

15 U.S.C. § 717 *et seq.* (1982) ..... *passim*
Section 4, 15 U.S.C. § 717c (1982) 2, 5, 7
Section 5, 15 U.S.C. § 717d (1982) ..... *passim*
Section 7, 15 U.S.C. § 717f (1982) 2, 12, 17

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 1144 and appears at Pet. App. A-1.[1] The court of appeals' orders denying rehearing and re-

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[1] References to "Pet. App. ——" appearing herein are to the Appendix to the Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit filed January 21, 1986 in Transwestern Pipeline Co. v. Federal Energy Regulatory Commission, No. 85-1219.

hearing *en banc*, are not officially reported and appear at Pet. App. A-57 and A-69, respectively. The orders of the Federal Energy Regulatory Commission (the "Commission") were issued in Docket No. RM83-71-000 and are identified as Order Nos. 380 (Pet. App. A-71), 380-A (Pet. App. A-129), 380-B (Pet. App. A-226), 380-C (Pet. App. A-231) and 380-D (Pet. App. A-271).

JURISDICTION

The decision of the court of appeals and its judgment in this case were entered August 20, 1985. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on October 25, 1985. This Court has jurisdiction to review the decision below pursuant to 15 U.S.C. § 717r(b) and 28 U.S.C. § 1254(1).

STATEMENT

1. Under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w(1982), sales of natural gas for resale by interstate pipelines are subject to the comprehensive jurisdiction of the Commission. No such sales can take place unless the Commission has issued a certificate of public convenience and necessity under Section 7 of the NGA. 15 U.S.C. § 717f(1982). Once the service is commenced, Section 4(a) of the NGA provides that the rates and charges are "subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." 15 U.S.C. § 717c(a) (1982). Under Section 5(a) of the NGA, if the Commission finds that "any rate, charge, or classifi-

cation. . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential," the Commission may fix by order the "just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed, and in force. . . ." 15 U.S.C. § 717d(a) (1982).

Generally, an interstate pipeline will have entered into a contract with each resale customer requiring the pipeline to provide, upon request on any given day, a maximum quantity of natural gas (the "daily contract quantity"). The rates for services to be charged under the contract will be contained in tariffs on file with and subject to the review of the Commission. To compensate the pipeline for the costs associated with providing gas sales service on demand, the tariff will require each customer to pay a monthly demand charge, based on the contract quantity, which recovers a portion of the fixed costs incurred by the pipeline in providing the service.[2] A customer must pay the demand charge, whether or not it actually requests or receives service during any billing period and irrespective of the level of service actually received. A customer also is required to pay a commodity charge based on the actual volume of gas purchased from the pipeline. The commodity charge is designed to recover the remaining portion of the pipeline's fixed costs and all variable costs, including purchased gas costs.

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[2] The exact portion depends upon the rate design used by the pipeline. The portions range from 25% to 70% of a pipeline's total fixed costs. Pet. App. A-76 n.14. *See generally* Columbia Gas Transmission Corp. v. F.E.R.C., 628 F.2d 578 (D.C. Cir. 1979).

In addition, some pipeline tariffs impose an additional charge, known as a minimum commodity bill. Minimum commodity bills require a customer to pay a charge for any shortfall in purchases below a specified level, ranging from 50% to 90% of the monthly or annual contract quantity, even though the customer does not actually purchase that quantity of gas.[3] Prior to the issuance of Order No. 380, most minimum bill charges were set at the level of the pipeline's commodity charge, including purchased gas costs. Thus, a pipeline customer purchasing only at the pipeline minimum bill level could never replace a unit of those purchases with alternate, less expensive supplies because the true cost of that unit, which would include the pipeline minimum bill charge, could never be less than the pipeline commodity price. Minimum commodity bills therefore established an effective floor on purchases by a customer from its supplying pipeline and placed a substantial restraint on the forces of competition.

2. In August 1983, the Commission issued a Notice of Proposed Rulemaking in which it proposed to remove all variable costs, including the cost of purchased gas, from the rates charged under minimum commodity bills. It noted that variable costs are not incurred when a pipeline does not make sales and therefore tentatively concluded that current minimum bills might allow pipelines to recover a "windfall." It also concluded that minimum commodity

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[3] The monthly quantity generally equals the daily contract quantity times the number of days in the applicable month. If a customer's entitlement to firm sales volumes is less than the daily contract quantity times the days in the applicable period, the percentage requirement of the minimum commodity bill usually is applied to that lower volume.

bills served as barriers to competition by preventing pipeline customers from purchasing less expensive sources of supply. After receiving an initial round of comments, the Commission allowed interested parties to file reply comments.

Thereafter, the Commission promulgated Order No. 380, based on its findings that minimum commodity bills recovered costs that were not actually incurred, Pet. App. A-82 to A-85, and, further, were "anticompetitive." Pet. App. A-85 to A-92. To implement these conclusions, the Commission promulgated a new section to its regulations, 18 C.F.R. § 154.111, effective August 30, 1984, which required all costs of purchased gas to be excluded from the rate charged when customers did not purchase gas at full minimum bill levels. Pet. App. A-123 to A-124.[4] All other variable costs were required to be eliminated from the minimum commodity bill when each pipeline made its next general rate filing under Section 4 of the NGA. *Ibid.* The Commission declined to adopt the suggestion of some parties that minimum commodity bills be eliminated in their entirety or be applied to a lesser percentage of contract quantity. Pet. App. A-114 to A-115. It therefore left intact the volumetric level of minimum commodity bills and the fixed cost portion of the rates charged thereunder.

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[4] The Commission also applied this provision to "minimum take provisions," which require customers physically to receive a specified amount of gas. The court of appeals upheld the Commission's decision to apply 18 C.F.R. § 154.111 to both minimum bill and minimum take provisions, holding that "there is no difference between the two types of clauses with respect to the Commission's rationale for the rule. . ." Pet. App. A-35 n.18.

The Commission's decision to leave intact the fixed cost portion of the rate charged under minimum commodity bills has several effects. First, it provides affected pipelines with continued assurances of recovery of the fixed costs contained in their commodity charges. Pet. App. A-22, A-138, A-143. Thus, pipelines will continue to have a full and fair opportunity to recover all costs actually incurred in meeting their contractual obligations to their customers.

Second, by retaining the pre-existing floor on the contribution to fixed cost recovery by each customer (*i.e.*, the demand charge plus commodity fixed costs for volumes up to the minimum bill level), the Commission's rule protects pipeline customers against the full impact of cost-shifting if purchase levels shift in response to Order No. 380.

Third, the scope of the Commission's action limits its competitive impact. Rather than exposing pipelines to the full brunt of gas-on-gas competition, the orders leave pipelines with a partial shield against competition. Under the rule, a pipeline's sales to a customer will drop below the minimum commodity bill level in response to competition only if the rates of competitors are lower than the pipeline's rates by an amount greater than the fixed costs contained in the pipeline's commodity charge. Even if that condition is met and a pipeline actually loses sales, the pipeline will remain shielded from the full financial impact of that competition because it will continue to recover those fixed costs.

Fourth, to the extent that sales are lost and take-or-pay liability results,[5] the Commission left undis-

[5] Under certain gas purchase contracts, a purchaser must take a specified amount of gas, or pay for that amount even if not taken. Pet. App. A-20 to A-21.

turbed those provisions of its regulations which allow a pipeline to recover the carrying-costs associated with take-or-pay liability. Pet. App. A-105 n.47. It also invited pipelines to file proposals to target those costs on specific customers if such proposals could be justified. Pet. App. A-106.

3. After petitions for rehearing were denied by the Commission, several parties petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Commission's orders, pursuant to 15 U.S.C. § 717r(b) (1982). The court of appeals affirmed the Commission, holding that the Commission had the statutory authority to issue the rule, because "Sections 4 and 5 of the Natural Gas Act empower the Commission to regulate rates, charges, and practices of natural gas companies under its jurisdiction." Pet. App. A-24 to A-25. The court of appeals also concluded that "[t]he Commission has provided abundant evidence that the recovery of variable costs through minimum bill and minimum take clauses prevents customers from shopping for low-cost gas, thereby insulating pipelines from market forces that would otherwise drive gas prices down." Pet. App. A-36. The court of appeals, after review of the record, then determined that "the Commission adequately addressed the concerns of captive customers," Pet. App. A-42, that "each of the order's essential elements is supported by substantial evidence," *ibid.*, and therefore that it was not its "province 'to supplant the Commission's balance of these interests with one more nearly to [our] liking.' *Permian Basin*, 390 U.S. at 792." *Ibid.* The court of appeals also held that the Commission was authorized to promulgate the rule after informal notice

and comment rulemaking because "the decision whether to proceed by rulemaking or adjudication lies within the broad discretion of the agency," Pet. App. A-51, and "the 'substantial evidence' provision in the Natural Gas Act does not affect the *procedure* the Commission is required to follow." Pet. App. A-54 (emphasis in original).

4. Northern Illinois Gas Company ("NI-Gas"), a respondent in this case, is a local distribution company engaged in the sale and distribution of natural gas to over 1,500,000 customers in northern Illinois. Historically, NI-Gas has purchased close to 100% of its supply from interstate pipelines, three of which have minimum commodity bills in the tariffs applicable to NI-Gas. Because these minimum commodity bills had increased the cost of gas to the consumers served by NI-Gas, NI-Gas actively supported the proposed rule and defended the final rule before the court of appeals. At the time the Commission was receiving comments in the rulemaking that resulted in Order No. 380, NI-Gas estimated that its consumers would save tens of millions of dollars per year as a direct result of the additional flexibility to substitute lower priced sources of gas for higher priced gas which NI-Gas previously had been forced to purchase. Because the rule increases NI-Gas' options for buying gas and the competition among pipelines and other sources of gas, NI-Gas anticipates that the combined impact of its increased flexibility and increased industry-wide competition will result in rates charged to its consumers that are tens of millions of dollars below the level which would prevail absent Order No. 380.

REASONS FOR DENYING THE PETITIONS

The unanimous decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. The court of appeals properly applied well-established standards for review of Commission action. After careful consideration of the record below, the court of appeals determined that the Commission's findings were supported by substantial evidence and that the Commission's actions were within its substantive authority and in accord with appropriate procedural safeguards. Petitioners' challenges to the decisions of the court of appeals and the Commission boil down to dissatisfaction with the application of settled legal principles to the facts of this particular record, and do not merit review by this Court.

I.

The decision below evidences no confusion as to the appropriate standards of review. It applies long-standing principles of judicial review of agency action in a carefully reasoned opinion. Having properly articulated these standards, the decision then applies them to a voluminous record, and determines that the actions of the Commission satisfy those standards. Thus, while the rule promulgated by the Commission might have broad impact, the review afforded by the court of appeals was sufficient to dispose of all of petitioners' contentions.

This Court has defined the responsibilities of a court reviewing agency actions taken under the NGA in the following terms:

> First, it must determine whether the Commissioner's order, viewed in light of the relevant

> facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests. . . . The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly of its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

Permian Basin Area Rate Cases, 390 U.S. 747, 791-792 (1968). As described more fully in Parts II and III of this brief, the court of appeals properly applied each of these standards in reviewing the actions of the Commission. First, the court of appeals considered whether the actions of the Commission were within its substantive authority under the NGA and properly concluded that they were. Second, the court of appeals reviewed the record and determined that each of the essential elements of Order No. 380 was fully supported by substantial evidence. Third, the court of appeals determined that Order No. 380 adequately protected investors by maintaining the fixed cost portion of minimum commodity bills and providing a fair opportunity for pipelines to recover all prudently incurred costs.

Thus, the present case involves a routine review of administrative action under well-established legal

principles. As this Court has made clear, the responsibility for assessing a record to determine whether agency findings are supported by substantial evidence "is not ours," but that of the "courts of appeals." "This Court will intervene only in what ought to be the rare instance where the standard appears to have been misapprehended or grossly misapplied." *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283, 309-310 (1974).

II.

The court of appeals concluded that the Commission had explicit statutory authority to take the actions herein challenged. Pet. App. A-25. Section 5(a) of the NGA, 15 U.S.C. § 717d(a) (1982), states that if the Commission "find[s] that any rate, charge. . . . or any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable," the Commission shall fix by order "the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed. . ." Minimum commodity bills establish the "just and reasonable rate" to be paid by a pipeline customer when it fails to achieve a contractually agreed-upon level of purchases. Pet. App. A-25 n.9. The Commission's rule did not alter those levels or a customer's obligation to compensate a pipeline for the prudently incurred costs of providing service. The orders merely concluded that a rate for shortfalls of purchases below a pipeline's minimum bill level *which recovers costs not actually incurred* is "unjust [and] unreasonable" within the meaning of Section 5 of the NGA, 15 U.S.C. § 717d(1982), and therefore prohibited that practice on a prospective basis. Such regulation of rates and charges is precisely the au-

thority granted the Commission by Section 5 of the NGA.[6]

Petitioners' efforts to portray the Commission actions as a prohibited alteration of certificates were properly rejected by the court of appeals, Pet. App. A-25 n.9,[7] and petitioners' reliance on cases such as *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947), is misplaced. A certificate of public convenience and necessity issued under Section 7 of the NGA confers upon the recipient the right and obligation to provide a specific service. Absent a certificate, a party is prohibited from providing the specified service. However, the determination of the just and reasonable rate level for a particular service, which must recognize the financial interests of the pipeline, is a far different matter from revoking a pipeline's right to provide that service. The orders of the Commission, which operate on a prospective basis only, leave intact the service rights and obligations of pipelines, including each customer's obligation to com-

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[6] Petitioners' reliance on United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956), and F.P.C. v. Sierra Pacific Power Co., 350 U.S. 348 (1956), is entirely misplaced. *E.g.*, No. 85-1219 Pet. at 8-11. Those cases deal only with the burden of proof and do not question the Commission's substantive ratemaking authority under Section 5 of the NGA when adequate findings are made by the Commission.

[7] The court of appeals also properly concluded that a certificate confers no guarantee that the initial terms of an approved service will not be changed, citing Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Upon appropriate showings, "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." Permian Basin Area Rate Cases, *supra*, 390 U.S. at 783-84.

pensate the pipelines, and the orders deal solely with the rates charged for one element of service. Thus, *Seatrain*, even if read as broadly as petitioners contend, is not relevant to the present case.

III.

Petitioners, in various guises, also argue that the Commission's rule "abrogates" contracts, destroys the "mutuality" of contracts, or denies pipelines the constitutionally-mandated fair opportunity to recover their costs. *E.g.*, No. 85-1250 Pet. at 9-10; No. 85-1236 Pet. at 9; No. 85-1237 Pet. at 10. As the court of appeals properly concluded, these arguments are devoid of merit. Pet. App. A-25 n. 9.

Under Order No. 380, pipeline customers remain obligated to pay a demand charge to compensate their supplying pipelines for standing ready to provide service up to the daily contract quantity specified in the contracts. Customers remain obligated to pay commodity charges for actual purchases and fixed costs for any minimum bill deficiency volumes. Simply put, pipeline customers remain obligated to compensate pipelines for costs prudently incurred to provide the contracted-for service, preserving mutuality between the providers and recipients of gas sales services. All the Commission did, by invoking its authority under Section 5 of the NGA, was to hold that it is "unjust [and] unreasonable" for a pipeline *to charge customers for costs which it has not incurred.*

This decision by the Commission is clearly within the power granted by the NGA and its finding that the previous rate structure for minimum commodity bill charges is unjust and unreasonable fully satisfies the requirements established by the Court in the *Mobile-Sierra* doctrine. The *Mobile-Sierra* line of

cases recognizes the primary role played by contracts under the NGA. It does not, however, prohibit the Commission from exercising its powers under Section 5 of the NGA to prescribe just and reasonable rates. The ability of the Commission to modify contractually specified rates is beyond peradventure. "The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential'." *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, *supra*, 350 U.S. at 341. *See also F.P.C. v. Louisiana Power and Light Co.*, 406 U.S. 621, 646-47 (1972).

The finding of the Commission that minimum bill charges which recover unincurred costs are unjust and unreasonable cannot be characterized as arbitrary or capricious. The two essential elements of the Commission's findings, that minimum bills authorize the recovery of unincurred costs and inhibit competition, are uncontroverted. Petitioners do not dispute the conclusion of the Commission that purchased gas costs are not incurred. At most, they argue that other costs, primarily take-or-pay costs which may be claimed by producers under gas purchase contracts, may be incurred if the orders remain in effect. They further argue that while minimum commodity bills admittedly restrain competition, such bills provide pipelines with both the constitutionally-protected fair opportunity to recover their prudently-incurred costs and the additional right to retain a fixed market share, irrespective of any other factors, citing *United States v. El Paso Natural Gas Company*, 376 U.S. 651, 659-660 (1964).

However, this claim misstates the law and the impact of the Commission rule. While minimum commodity bills have been justified for several reasons,[8] an absolute grant of immunity from competition is not one of those reasons. The Commission may promote competition to better serve the public interest.[9] The sole issue is whether its actions properly recognize the financial interests of pipelines and fairly compensate investors. *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 790-91; *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942); *Lynchburg Gas Co. v. F.P.C.*, *supra*, 336 F.2d at 949-50 (Washington, J., concurring).

The Commission's rule, as found by the court of appeals, strikes a reasonable balance between effective competition and the expectations of investors in a manner consistent with the requirements established by this Court. The final Commission rule provides each affected pipeline with a full and fair opportunity to recover its cost of service, including the costs associated with any increased take-or-pay liability. Demand charges, which recover a significant portion of pipeline fixed costs, are unaffected by the rule. The fixed costs recovered through the pipeline's commodity charge are also unaffected because the

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[8] *See generally* Mississippi River Transmission Corp. v. F.E.R.C., 759 F.2d 945 (D.C. Cir. 1985); Atlantic Seaboard Corp. v. F.P.C., 404 F.2d 1268 (D.C. Cir. 1968); Lynchburg Gas Co. v. F.P.C., 336 F.2d 942 (D.C. Cir. 1964). Both the Commission and the court of appeals concluded that Order No. 380 satisfied the standards set forth in those cases.

[9] *See generally* Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); Atlantic Seaboard Corp. v. F.P.C., *supra*, 404 F.2d at 1272; Northern Natural Gas Co. v. F.P.C., 399 F.2d 953, 964-65 (D.C. Cir. 1968).

minimum commodity bills continue in effect, at pre-existing levels, for such fixed costs. Only variable costs, which by definition are *not* incurred when purchases are not made, are excluded from recovery through the minimum bill charge.

Petitioners argue, however, that these unincurred variable costs are a proxy for take-or-pay costs which are an inevitable result of Order No. 380. This argument overlooks the fact that if a pipeline loses sales due to the rule and therefore incurs take-or-pay liability to producers, those costs may be reflected in its rates. Such payments, if prudently incurred, are placed in the pipeline's rate base and the pipeline may recover in its rates the carrying costs associated with that rate base account. Pet.App. A-105 n. 47. Thus, the pipeline receives a full and fair opportunity to recover its costs. The consumers' interests are therefore balanced with the pipeline's financial health. *Cf.*, *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 792; *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Arguments that the Commission's rule creates a new market structure or results in confiscatory rate structures are completely without merit.

Certain petitioners also argue that the rule is arbitrary because it will foster cost-shifting among customers. *E.g.*, No. 85-1236 Pet. at 11. But the continued availability of demand charges and fixed cost minimum commodity bills limits the potential for the shifting of fixed costs among customers. The sole potential for such cost-shifting arises if and when the pipeline reflects in its rates take-or-pay costs caused by the rule. To the extent any misallocation results, the Commission has invited pipelines to

propose allocations which properly assign such costs. Pet. App. A-106.

Thus, pipelines will continue to be fairly compensated for all costs prudently incurred in providing sales service up to the maximum contract quantities embodied in the service agreements. The financial obligations of pipeline customers remain tied to the same benchmarks. The Commission's rule merely seeks to promote competition by prohibiting pipelines from recovering costs which they themselves must acknowledge are not incurred.

IV.

The Commission adopted its rule after an informal notice and comment process, allowing for the filing of reply comments as well as the statutorily authorized petitions for rehearing. The court of appeals affirmed this use of informal rulemaking proceedings as consistent with the statutes, its precedents, and the decisions of this Court.

The statutes and precedents authorize the Commission to establish rates pursuant to rulemaking procedures.[10] Section 403(c), of the Department of Energy Organization Act, 42 U.S.C. § 7173(c)(1982) ("DOE Act"), states: "Any function. . . . which relates to the establishment of rates and charges under the. . . . Natural Gas Act, may be conducted by rulemaking procedures." Moreover, this Court has clearly sanctioned agency discretion in selecting its procedures:

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[10] Petitioners argue that, in promulgating the rule, the Commission was not exercising its ratemaking authority. No. 85-1219 Pet. at 22-25; No. 85-1252 Pet. at 10-12. We have responded to this argument on pp. 11-13, *supra*.

> Absent constitutional constraints or extremely compelling circumstances the "administrative agencies 'should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties'." *FCC v. Schreiber*, 381 U.S., at 290, 85 S. Ct. at 1467, quoting from *FCC v. Pottsville Broadcasting Co.*, 309 U.S., at 143, 60 S. Ct., at 441. Indeed, our cases could hardly be more explicit.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519, 543-44 (1978). An agency may choose to proceed through either adjudication or rulemaking proceedings, *SEC v. Chenery Corp.*, 332 U.S. 194, 201-03 (1947), and it must "be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." *Permian Basin Area Rate Cases, supra*, 390 U.S. at 790. The statutory requirement of a hearing may be satisfied by written comments. *United States v. Florida East Coast Ry. Co.*, 410 U.S. 224, 241 (1973). Given the Court's decisions in *Vermont Yankee* and *Florida East Coast Ry.*, the courts of appeals in this case and others consistently have concluded that the Commission may proceed by rulemaking in carrying out its responsibilities under the NGA. *E.g.*, Pet. App. A-50 to A-56; *Phillips Petroleum Co. v. F.P.C.*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *Tenneco Oil Co. v. F.E.R.C.*, 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1979).

Petitioners nonetheless argue that *Florida East Coast Ry.* and *Vermont Yankee* prohibit the use of informal rulemaking procedures in this context because "disputed facts" were raised and the Commis-

sion was "making a 'quasi-judicial' determination by which a very small number of persons are 'exceptionally affected, in each case, upon individual grounds, . . .'" No. 85-1237 Pet. at 12, *citing Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, *supra*, 435 U.S. at 542. This argument is meritless because the present case clearly raises "policy-type rules or standards" applicable to all competitors in a regulated industry.[11] The conclusion of the Commission that minimum commodity bills permit the recovery of unincurred costs cannot be disputed, nor can the conclusion that such minimum commodity bills adversely affect competition. And the balance to be struck between competition and other values under the NGA, within constitutional and statutory limits, is plainly a matter for industry-wide application. Indeed, any attempt to resolve these industry-wide issues on a case by case basis would have had significantly greater impact on individual pipelines.

Despite petitioners' attempt to fabricate new legal standards, the law requires only that substantial evidence support the essential elements of the Commis-

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[11] In its Order on Rehearing, the Commission specifically considered and addressed the arguments raised by the individual pipelines. Pet. App. E. This careful consideration of the individual circumstances of the pipelines satisfies any procedural rights due to them. Furthermore, while the Commission concluded that all minimum bills which recover variable costs are unjust and unreasonable, it also concluded that it would not eliminate fixed cost minimum bills on a generic basis. Pet. App. A-115. The Commission has continued to consider fixed cost minimum commodity bills on their individual merits. *E.g.*, Tennessee Gas Pipeline Co., 32 F.E.R.C. ¶ 61,311 (1985); Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985).

sion's order. It must be stressed that, as well as ruling on the procedure followed by the Commission, the court of appeals specifically found that "each of the order's essential elements is supported by substantial evidence." Pet. App. A-42. The court of appeals found that the procedures adopted by the Commission produced an adequate record, specifically including substantial evidence to support each essential element of the Commission's decision. The capacity of procedures to produce substantial evidence, not the procedural method itself, is the relevant issue. As this Court has held, "Congress . . . . specified necessary components of the ultimate decision, but it did not specify the method by which the Commission should acquire information about these components." *United States v. Florida East Coast Ry. Co., supra,* 410 U.S. at 235.

The DOE Act specifically authorizes the use of rulemaking procedures in ratemaking matters. 42 U.S.C. § 7173(c) (1982). The court of appeals found that the essential elements of the Commission's decisions are supported by "substantial evidence", thereby satisfying the mandates of the NGA. Thus, the conclusion of the court of appeals that the "substantial evidence" standard of the NGA "does not dictate the procedure to be followed . . . . [but] has to do with a court's review of the adequacy *vel non* of the evidence relied upon to support a finding, whatever the kind of hearing," Pet. App. A-55 (citing *American Public Gas Association v. F.P.C.*, 567 F.2d 1016, 1067 (D.C. Cir. 1977)), was mandated by the decision of this Court in *Vermont Yankee*:

> [T]he adequacy of the "record" in this type of proceeding is not correlated directly to the type of procedural devices employed, but rather turns on whether the agency has followed the statutory

> mandate of the Administrative Procedure Act or other relevant statutes. . . In short, nothing in the APA, NEPA, the circumstances of this case, the nature of the issues being considered, past agency practice, or the statutory mandate under which the Commission operates permitted the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory *minima*, a matter about which there is no doubt in this case.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., *supra*, 435 U.S. at 547-48.

CONCLUSION

The petitions for a writ of certiorari should be denied.

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Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

VS.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT SOUTHERN CALIFORNIA GAS COMPANY IN OPPOSITION TO PETITIONERS

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BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (Commission) has the authority under Section 5 of the Natural Gas Act to modify tariff provisions when the Commission finds that those tariff provisions have anti-competitive effects.

2. Whether the Commission's notice and comment procedures in a formal rulemaking proceeding satisfy the requirements of the Natural Gas Act.

3. Whether the Commission's finding that minimum commodity bill and minimum take provisions in tariffs have anti-competitive effects was supported by substantial evidence.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED FOR REVIEW	i
TABLE OF AUTHORITIES.....	iii
LIST OF PARENT, SUBSIDIARIES AND AFFILIATES	v
STATEMENT OF THE CASE.....	2
REASONS WHY THE WRIT SHOULD BE DENIED.....	4
I.	
The Court's Decision Below Follows An Unbroken Line Of Authority In Finding That The Commission Acted Within Its Authority To Modify Tariffs And Contracts Under Section 5 Of The Natural Gas Act.....	4
II.	
The Court's Decision Below Does Not Raise Certain Of The Questions Presented In The Petitions	6
III.	
As The Court Below Found, The Commission Utilized The Proper Procedures And Therefore There Is No Reason For This Court To Grant The Writ For Certiorari	8
IV.	
The Court's Decision Below Gave Full Consideration To The Issues And Determined That The Commission's Decision Was Based Upon Substantial Evidence	9
CONCLUSION.....	11

TABLE OF AUTHORITIES

Court Cases

	Page
American Smelting and Refining Co. v. FPC, 494 F.2d 925 (D.C. Cir. 1974), *cert. denied*, 419 U.S. 882 (1974)	7
Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1950)	7
Colorado Interstate Gas Co. v. FPC, 142 F.2d 943 (10th Cir. 1944), *aff'd.*, 324 U.S. 581 (1945), *reh'g denied*, 325 U.S. 891 (1945)	10
FPC v. Transcontinental Gas Pipeline Corp., 423 U.S. 326 (1976)	8
Pacific Gas Transmission Co. v. FPC, 536 F.2d 393 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 999 (1976)	7
Pacific Lighting Service Co. v. FPC, 518 F.2d 718 (9th Cir. 1975)	4
Permian Basin Area Rate Cases, 390 U.S. 747 (1968), *reh'g denied*, 392 U.S. 917 (1969)	5, 6, 10
Phillips Petroleum Co. v. FPC, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974)	8
Public Service Commission of the State of New York v. FERC, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 454 U.S. 879 (1981)	9
SEC v. Chenery Corp., 332 U.S. 194 (1974)	8
United States v. Florida East Coast Ry. Co., 410 U.S. 224 (1973)	8, 9
Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978)	9

TABLE OF AUTHORITIES

Page

Commission Cases

El Paso Natural Gas Co., 26 FERC ¶ 61,423 (1984) 4

El Paso Natural Gas Co., 34 FERC ¶ 61,171 (1986) 4

Transwestern Pipeline Co., 26 FERC ¶ 61,424 (1984) 4

Transwestern Pipeline Co., 34 FERC ¶ 61,201 (1986) 4

Statute

Natural Gas Act, 15 U.S.C. §§ 717-717w (1982) . . *passim*

LIST OF PARENT, SUBSIDIARIES AND AFFILIATES

Southern California Gas Company (SoCalGas) is a wholly-owned subsidiary of Pacific Lighting Corporation. The following are the parent, subsidiaries and affiliates of SoCalGas:

Ankirk
Blackfield Hawaii Corporation
California LNG Company
Carmel Mountain Properties
Central Plants, Inc
Dual Fuel Systems, Inc.
Dunn Properties Corporation
Dunn Properties of Georgia, Inc.
Dunn Properties of Texas, Inc.
Fredericks Sales, Inc.
Fredricks Development Corporation
Fuel Industries New Zealand Limited
Hawaii Management Corporation
Mayflower Realty Associates, Inc.
Modular Products, Inc.
Nellie Gail Ranch Recreation Company
Pacific Alaska LNG Company
Pacific Center Downtown, Inc.
Pacific Energy Resources Incorporated
Pacific Gas Gathering Company
Pacific Geothermal Company
Pacific Hydropower Company
Pacific Indonesia LNG Company
Pacific Interstate Company
Pacific Interstate Mojave Company
Pacific Interstate Offshore Company
Pacific Interstate Transmission Company
Pacific Interstate Transmission Company (Arctic)

Pacific Lighting Bio-Energy Company
Pacific Lighting Capital Company N.V.
Pacific Lighting Commercial Loans, Inc.
Pacific Lighting Corporation
Pacific Lighting Energy Systems
Pacific Lighting Exploration Company
Pacific Lighting Gas Development (Canada) Ltd.
Pacific Lighting Gas Development Company
Pacific Lighting International Finance N.V.
Pacific Lighting Land Company
Pacific Lighting Leasing Company
Pacific Lighting Marine Company
Pacific Lighting Oil and Gas Company
Pacific Lighting Overseas Finance N.V.
Pacific Lighting Properties, Inc.
Pacific Lighting Real Estate Group
Pacific Lighting Securities Company
Pacific Offshore Pipeline Company
Pacific Oroville Power, Inc.
Pacific Synthetic Fuel Company
Presley ASW Finance Co., Inc.
Presley Chicago, Inc.
Presley Company East, Inc.
Presley Company of New Mexico
Presley Development Company of Arizona
Presley Financial Corporation
Presley-Home Mac Finance Co., Inc.
Presley of Northern California
Presley of San Diego
Presley of Southern California
Sabagli N.V.
S. M. Dunn, Inc.
SMA Development Corporation
Southern California Conservation Financing Company

Southern California Gas International Finance N.V.
Southern California Solar Financing Company
Terra Resources, Inc.
The Presley Companies
Western LNG Terminal Company
Western Power, Inc.

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

In the Supreme Court

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OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

VS.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT SOUTHERN CALIFORNIA GAS COMPANY IN OPPOSITION TO PETITIONERS

Respondent, Southern California Gas Company (SoCalGas),[1] respectfully requests that this Court deny the Petitions for Writ of Certiorari, seeking review of the District of Columbia Circuit Court of Appeals' opinion in this case. App. at 1.[2] This case involves no conflict between the Circuits, raises no Constitutional question, and

[1]SoCalGas and its affiliate, Pacific Lighting Gas Supply Company (PLGS), were parties below. Recently, SoCalGas and PLGS merged and are operating under the name of SoCalGas.

[2]The appendix references are to the appendix filed with this Court by Transwestern Pipeline Company.

involves no significant issue concerning the administration of the Natural Gas Act. 15 U.S.C. §§ 717-717w (1982).

STATEMENT OF THE CASE

This case involves the Federal Energy Regulatory Commission's (Commission) promulgation of a rule which eliminates non-incurred variable gas costs from the tariffs of interstate pipelines. Under the rule, the pipelines continue to collect, unchanged, the fixed costs in their tariffs. These fixed costs include the non-gas costs of a pipeline such as wages, operation and maintenance expenses, depreciation and return on rate base. The pipelines also continue to collect the gas costs which they incur for the gas they sell. However, pipelines can no longer bill and collect from their customers for gas costs which they do not incur.

The Commission has applied this rule to both minimum commodity bills and minimum take provisions. Minimum commodity bills require customers of pipelines to pay for minimum quantities of gas whether or not it is taken. Minimum take provisions are even more restrictive, requiring customers of pipelines to actually take a minimum quantity of gas whether or not they want it. Both of these minimum bill provisions severely restricted a customer's discretion in making purchases.

Six natural gas pipeline companies have filed Petitions with this Court to seek review of a unanimous decision of the Court of Appeals for the District of Columbia Circuit which affirmed the Commission's Orders in all respects, except one which is not a subject of these Petitions.[3]

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[3]Petitions have been filed by Transwestern Pipeline Company (Transwestern) (No. 85-1219); ANR Pipeline Company (ANR) (No. 85-1236); Texas Eastern Transmission Corporation (Texas Eastern)

Petitions for Rehearing were denied by the Court of Appeals, with no member requesting the taking of a vote on the Petitions. App. at 69, 70.

SoCalGas is a natural gas distribution company which provides natural gas service in southern and central California. SoCalGas is the largest natural gas distribution company in the country having more than 4.0 million customers and providing natural gas service to a population of approximately 13.0 million. SoCalGas purchases natural gas from a number of interstate pipeline companies including Transwestern Pipeline Company (Transwestern), one of the Petitioners before this Court.

Under the provisions in Transwestern's tariff, SoCalGas had the annual obligation to take or pay for 91 percent of a contract quantity of 750,000 Mcf of gas per day. Transwestern's tariff provisions also required that SoCalGas actually take from Transwestern, regardless of its need and regardless of the cost, on a daily basis, 80 percent of the contract quantity of 750,000 Mcf or 600,000 Mcf of gas. If SoCalGas did not need this volume of gas on a daily basis it was still required to take such volumes.

The Commission's Order Nos. 380, 380-A, 380-B, 380-C and 380-D[4] relieved SoCalGas of these severe tariff restrictions and allowed it to purchase gas based upon relative cost rather than these tariff provisions.[5]

(No. 85-1237); Trunkline Gas Company and Panhandle Eastern Pipeline Company (No. 85-1250); and Arkla Energy Resources (Arkla) (No. 85-1282).

[4]These orders are referred to in this brief as "Order No. 380."

[5]It should be noted that other provisions in Transwestern's tariff relieve Transwestern of the obligation to provide the contracted quantity of gas during periods when gas is unavailable. These tariff provisions which were placed in Transwestern's tariff long after Transwestern's contract was signed with SoCalGas were approved by

The Commission's intention of promoting competition among interstate pipelines in issuing Order No. 380 has had its desired effect. For example, Transwestern which at the time of the issuance of Order No. 380 was a higher priced supplier to SoCalGas, has, in response to competition generated by Order No. 380, become the low price leader of the suppliers to southern California.[6] As the result of discretionary actions which Transwestern has taken, it has significantly reduced its commodity rate to SoCalGas. The ratepayers of SoCalGas are the ultimate beneficiaries of this reduction.

REASONS WHY THE WRIT SHOULD BE DENIED

I

The Court's Decision Below Follows An Unbroken Line Of Authority In Finding That The Commission Acted Within Its Authority To Modify Tariffs And Contracts Under Section 5 Of The Natural Gas Act.

Petitioners here launch what the Court below termed a "barrage of attacks upon the Commission's authority to issue Order No. 380." App. at 25. The Commission's authority to act under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d (1982), is so clear, and the arguments by

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the Commission and upheld by the Ninth Circuit Court of Appeals in *Pacific Lighting Service Co. v. FPC,* 518 F.2d 718 (9th Cir. 1975).

[6]Prior to the effective date of Order No. 380, Transwestern's commodity rate of $3.85/MMBtu was significantly higher than the $3.57/MMBtu commodity rate of El Paso Natural Gas Company (El Paso), which is Transwestern's major competitor in the southern California market. *Compare Transwestern Pipeline Co.*, 26 FERC ¶ 61,424 (1984) with *El Paso Natural Gas Co.*, 26 FERC ¶ 61,423 (1984). Currently Transwestern's commodity rate is $2.87/MMBtu compared to El Paso's current commodity rate of $2.98/MMBtu. *Compare Transwestern Pipeline Co.*, 34 FERC ¶ 61,201 (1986) with *El Paso Natural Gas Co.*, 34 FERC ¶ 61,171 (1986).

the Petitioners are so tenuous, that the Court below found that the Petitioners' claims concerning the Commission's authority to act were either "frivolous" or "completely without merit." App. at 25.

Simply put, an argument cannot credibly be made that the Commission exceeded its authority in issuing Order No. 380. Section 5 of the Natural Gas Act empowers the Commission upon finding "that any rate, charge, or classification . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential" to determine the just and reasonable rate or contract and to fix that rate or contract by order. 15 U.S.C. § 717d(a). The Court below, in citing to this Court's decision in *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-84 (1968), stated, "At any rate, Section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable' ". App. at 25-26.

In fact, Petitioners acknowledge that the Commission is authorized under Section 5 of the Act to modify contracts and tariffs. *See* Transwestern's Petition at 9, Texas Eastern's Petition at 11. Petitioners cite no case which challenges the Commission's authority to modify tariffs or contracts. Instead, Petitioners argue that the Commission exceeded its authority because it did not fully consider the role of contracts under the Natural Gas Act or that the provisions of Order No. 380 destroy the mutuality of contracts. In essence, these arguments by Petitioners, while termed to be challenges to the statutory authority of the Commission to issue its Order, are in reality merely disagreements with the Commission's weighing of the various factors which were considered in issuing its decision. The role of this Court is not to weigh the individual factors in evidence but to defer to the

expertise of the administrative agency in considering the evidence before it. *Permian Basin,* 390 U.S. 747 (1968).

II

The Court's Decision Below Does Not Raise Certain Of The Questions Presented In The Petitions.

Petitioners have raised for review certain issues which were not the holding in the decision of the Court below. First, Petitioners question if the Commission is authorized to abrogate a settlement agreement which was previously approved by the Commission. Second, Petitioners question if the Commission is authorized to modify or revoke a certificate of public convenience and necessity issued under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982). The District of Columbia Circuit Court of Appeals either did not decide these issues or did not base its decision upon such finding. Moreover the facts below indicate there was no violation of a settlement or revocation of a certificate.

A Petitioner, ANR, contends that the Commission has exceeded its statutory authority by abrogating a settlement agreement to which the Commission was a party. The District of Columbia Circuit however did not decide this issue. The Court below stated, "We find that Order No. 380 does not violate any term of either Transco's or ANR's settlement. We therefore do not reach the issue of whether the Commission has the statutory authority to abrogate settlement agreements to which it is a party through a generic section 5 rulemaking." App. at 26.

Moreover, the record in this proceeding does not permit the formulation of a resolution of this question presented by the Petitioner. The underlying settlement merely provides that the minimum bill issue shall be set for hearing in Docket No. RP82-80. (ANR attachment I at

B-1). In discussing this settlement the Court below found that the Commission was not restricted in dealing with ANR's minimum bill in an ongoing rulemaking. The Court stated, "As it is written, however, the agreement neither binds the Commission to resolve the issues in ANR's ratemaking proceeding nor exempts ANR's minimum bill provisions from the general rulemaking in progress. We conclude, therefore, that by issuing Order No. 380 the Commission did not violate the terms of the settlement agreement." App. at 29.

Petitioners, Transwestern and Arkla, claim that the Commission was without authority to revoke or modify certificates of public convenience and necessity granted under Section 7 of the Natural Gas Act. 15 U.S.C. § 717f. While the Court found that the Commission did have the authority to modify certificates, its holding was not based upon this finding. The Court below, citing this Court's decision in *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 389 (1959), found that Section 7 of the Natural Gas Act does not guarantee a recipient of a certificate that the initial terms of the certificate will never be changed. The Commission has the authority under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d, to alter and amend terms and conditions of certificated service. *Pacific Gas Transmission Co. v. FPC*, 536 F.2d 393 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 999 (1976). In fact, once the Commission determines a term or condition is unjust and unreasonable it must remedy the situation. *American Smelting and Refining Co. v. FPC*, 494 F.2d 925 (D.C. Cir. 1974), *cert. denied*, 419 U.S. 882 (1974); *Pacific Gas Transmission Co. v. FPC,* 536 F.2d 393 (D.C. Cir. 1976).

The decision of the Court below would not change even if its determination is incorrect since the Court found that the Commission's decision did not revoke or modify

the Section 7 certificates of Petitioners. The Court stated:

> Even assuming *arguendo* that the Commission has no authority to amend or revoke certificated service in a Section 5 proceeding, the elimination of minimum bills has no effect on the pipelines *authorized* service. The Order merely addresses the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to Section 5.

App. at p. 25, n.9 (emphasis in original). Thus, the issues which Petitioners have asked this Court to review are simply not material to the decision of the Court below.

III

As The Court Below Found, The Commission Utilized The Proper Procedures And Therefore There Is No Reason For This Court To Grant The Writ For Certiorari.

Petitioners argue that the rulemaking procedures used by the Commission in this case were insufficient to satisfy the hearing requirement of Section 5 of the Natural Gas Act. The statutory requirement for a hearing can be satisfied through either a rulemaking proceeding or an adjudicatory proceeding. *SEC v. Chenery Corp.*, 332 U.S. 194 (1947); *Phillips Petroleum Co. v. FPC*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974). In this case, the Commission within its discretion, utilized its rulemaking procedures. The Court below found that the Commission's decision to proceed through rulemaking, "clearly passes muster under our deferential standard of review." App. at 51. *See, FPC v. Transcontinental Gas Pipeline Corp.*, 423 U.S. 326, 333 (1976).

The use of notice and comment procedures by the Commission was an appropriate method to acquire information on an industry-wide problem. *See, United States v.*

Florida East Coast Ry. Co., 410 U.S. 224, 245 (1973). The fact that 95 parties submitted over 1,000 pages of comments in response to the Commission's first notice of proposed rulemaking indicates that the Commission's proposed rulemaking was not a matter that uniquely or exceptionally affected only a few parties. A review of the two series of comments and reply comments filed with the Commission reveals that all sectors of the natural gas industry took the opportunity to make their views known and address the arguments raised by other parties.

The repeated notices and comments which characterize this proceeding demonstrate the thorough procedures used by the Commission. As this Court has stated, and as noted by the Court below, App. at 54, nothing permits "the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory minima." *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 548 (1978). There is no doubt that the Commission has done so here.

IV

The Court's Decision Below Gave Full Consideration To The Issues And Determined That The Commission's Decision Was Based Upon Substantial Evidence.

Petitioners raise a wide-range of issues which, in essence, challenge the reasonableness of the Commission's Order. Pursuant to Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b), the standard which is to be used by a Court in reviewing the Commission's factual findings is that of substantial evidence. *Public Service Commission of the State of NewYork v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 454 U.S. 879 (1981). The factual findings of the Commission are to be considered conclu-

sive if supported by substantial evidence. In this regard the Court is not to substitute its view of the facts for that of the Commission. *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943 (10th Cir. 1944), *aff'd.*, 324 U.S. 581 (1945), *reh'g denied*, 325 U.S. 891 (1945).

The Commission's examination of all aspects of this rule can only be described as overwhelming and conclusive. In fact, the reviewing Court below has so found. The Court's conclusion is illustrative in describing the breadth of the Commission's review where it states,

> In sum, we find that each of the order's essential elements is supported by substantial evidence. Since we have assured ourself "that the Commission has given reasoned consideration to each of the pertinent factors", it is not our province "to supplant the Commission's balance of these interests with one more merely to [our] liking", *Permian Basin*, 390 U.S. at 792.

App. at 42.

Thus, Petitioners' claims simply do not merit review by this Court.

CONCLUSION

For these reasons, the Petitions for a Writ of Certiorari should be denied.

Respectfully submitted,

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Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

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On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF CONSUMERS POWER COMPANY, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
INTRODUCTION	1
STATEMENT OF THE CASE	2
ARGUMENT	6
CONCLUSION	10
APPENDIX: List of Respondents' Parents, Affiliates, and Subsidiaries That Are Wholly-Owned	1a

TABLE OF AUTHORITIES

CASES:

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959)	6
FPC v. Texaco, Inc., 377 U.S. 33 (1964)	9
Northern Natural Gas Co. v. FPC, 399 F.2d 953 (D.C. Cir. 1968)	8
Permian Basin Area Rate Cases, 390 U.S. 747 (1968)	9
Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi, 106 S. Ct. 709 (1986)	3, 8
United States v. Florida East Coast Railway, 410 U.S. 224 (1973)	9
Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978)	9
Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985)	7

STATUTES:

Department of Energy Organization Act, Section 403(c), 42 U.S.C. § 7173(c) (1982)	9
Natural Gas Act, 15 U.S.C. §§ 717-717w (1982)	2
Section 5, 15 U.S.C. § 717d	9
Section 7, 15 U.S.C. § 717f	8
Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432 (1982)	3, 8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF CONSUMERS POWER COMPANY, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI

INTRODUCTION

Respondents Consumers Power Company, Michigan Consolidated Gas Company, Natural Gas Pipeline Company of America, the Peoples Gas Light and Coke Company, American Iron and Steel Institute, Process Gas Consumers Group, Kansas Corporation Commission, Inter-City Gas Corporation, Michigan Gas Utilities Company, State of Michigan, Michigan Public Service Commission, Public Utilities Commission of the State of

California, Chattanooga Gas Company, a Division of Jupiter Industries, Inc., Columbia Gas Transmission Corporation, Consolidated Gas Transmission Corporation, Brooklyn Union Gas Company, and Public Service Commission of the State of New York file this brief in opposition to the petitions for certiorari in the above-captioned cases.[1]

STATEMENT OF THE CASE

This case involves orders issued by the Federal Energy Regulatory Commission (FERC or Commission), after extensive rulemaking proceedings, pursuant to provisions of the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982). The orders (the Order No. 380 series) prohibited interstate natural gas pipelines from imposing either (a) "minimum commodity bills" that require customers to pay for "variable costs" [2] with respect to minimum volumes of gas they do not actually purchase, or (b) "minimum take" provisions that require the purchase and receipt of specified volumes of gas.[3] Five natural gas pipeline companies have filed petitions for certiorari, seeking review of the unanimous decision of the United States Court of Appeals for the District of Columbia Circuit (Judges Tamm, Mikva, and Starr) that upheld those orders in all pertinent respects. The Court of Appeals also denied rehearing and rehearing en banc, with no member of the court requesting a vote for an en banc hearing.

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[1] A list of these respondents' parents, affiliates, and subsidiaries that are not wholly-owned is attached as an appendix to this brief.

References in the form "A.——" are to the Appendix to the Petition for a Writ of Certiorari filed by Transwestern Pipeline Company in No. 85-1219.

[2] These "costs" typically included payment of the pipeline's purchase price of gas, even if it was not acquired by the pipeline and delivered through the pipeline's system.

[3] The respondents have addressed in this brief only minimum bill, rather than minimum take, provisions.

The orders at issue represent an exercise of the FERC's authority and responsibility to conform its policies to new legislation and the shifting requirements of the public interest. In its initial notice of proposed rulemaking, the FERC noted a number of developments since the enactment in 1978 of the Natural Gas Policy Act (NGPA), 15 U.S.C. §§ 3301-3432 (1982), that changed the role and significance of minimum bills and demonstrated the need for a comprehensive reevaluation of those provisions. (A-79 to A-81.) The NGPA represented a fundamental departure from the previous statutory scheme governing prices paid for natural gas at the point of its production, i.e., at the wellhead. It established "a new system of natural gas pricing . . . needed to balance supply and demand." *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986). Under this regime, which calls for gradual deregulation of the wellhead prices for some categories of gas, "[t]he new federal role is to 'overse[e] a national market price regulatory scheme.'" *Id.* (citation omitted).

The FERC noted that the effectiveness of the NGPA's new market-based scheme of gas pricing was being significantly impeded by the presence of minimum bill provisions, which effectively compelled customers to purchase or pay for a predetermined volume of gas from a particular supplier, without regard to the price of or need for that gas. The FERC found that the economic roles of supply, demand, and price were undermined when a customer's purchases from a pipeline were dictated by a factor unrelated to the need for the gas or the availability of alternate supplies at a more favorable price. The FERC (without reference to antitrust law or analysis) characterized this feature of minimum bills as potentially anticompetitive and found the recovery of gas purchase costs (as well as other variable costs) through minimum bill provisions to be unjust and un-

reasonable and thus contrary to the requirements of the Natural Gas Act. (A-82 to A-85.)

The FERC also noted that the overall supply and demand characteristics of the industry had changed significantly since the passage of the NGPA. The NGPA permitted producers to charge higher, "incentive" prices for gas at the wellhead, and in response to these higher prices significant incremental supplies of gas became available. Roughly coincident with this increase of supply, a series of factors—conservation, a decline in worldwide petroleum prices, and the economic recession of the early 1980s—dramatically reduced the nationwide demand for gas. These countervailing trends—increasing natural gas supplies and diminishing demand for gas—left many pipeline customers without adequate markets for the gas they were required to purchase or pay for under their minimum bills. Under such circumstances, a pipeline that received payment for gas not purchased could "recover" costs that it did not incur and obtain windfall profits.[4] The Commission found that minimum bills operating in this fashion are unjust and unreasonable. (A-82 to A-85.)

Although many parties in the rulemaking had urged the total elimination of minimum bills, the FERC limited its orders to preclude only the recovery of variable costs through minimum bills. The Commission declined in the rulemaking to prohibit the recovery of fixed costs by pipelines through minimum bill provisions or customer demand charges.[5] Fixed costs are, by regulatory

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[4] Consumers Power Company, for example, estimated that it would have faced $250 million of minimum bill penalties to Trunkline Gas Company in the absence of a short-term settlement of a litigated proceeding before the FERC in 1983. (A-82.)

[5] For a description of the manner in which demand charges and commodity charges are structured under a typical two-part rate for pipeline sales service, see A-71 to A-73.

definition, those costs incurred by a pipeline whether it purchases and sells gas or not.

Noting the limited nature of its action, the Commission rejected the argument that the prohibition of variable-cost minimum bills amounted to a "restructuring" of the gas industry because it would relieve customers of the obligation to purchase gas without relieving pipelines of the obligation to provide service upon demand. The FERC observed that this argument overlooks that Order No. 380 permits a pipeline to continue to recover fixed costs through the operation of demand charges, which customers pay "whether or not they buy gas." (A-93.)

The Commission specifically addressed concerns about so-called "take-or-pay" provisions in pipeline-producer contracts under which pipelines undertake to prepay producers for a minimum quantity of gas over a specified period. To the extent that such prepayments are not satisfied by the pipeline's ultimate receipt of the prepaid gas, they may generate costs. The Commission noted that a pipeline may seek to recover such costs from its customers, if the pipeline in fact incurs them (A-77 to A-78), and Order No. 380 permits pipelines to continue to recover any such take-or-pay costs that are prudently incurred. The Commission also explained that the difficult issues pertinent to the distribution of prepayment costs among a pipeline's customers would be addressed in individual pipeline rate cases. (A-102 to A-107.)

The FERC's orders have had an immediate, concrete, and beneficial impact on the millions of consumers of gas nationwide, by precluding natural gas pipeline companies from charging their customers for gas that they did not purchase and costs that the pipelines did not incur. Order No. 380 has saved consumers millions of dollars, as the rulemaking record compiled before the FERC demonstrated it would. The Commission's actions

were essential to the administration of the Natural Gas Act, the purpose of which is "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959).

ARGUMENT

The petitions for writs of certiorari raise a multitude of issues. However, there is no conflict among the circuits with respect to any of the issues raised, and none of the issues is of sufficient importance to warrant this Court's review.

1. Petitioners contend that the Commission's orders endanger pipeline recovery of fixed costs and threaten to shift those costs to full requirements customers. The Commission specifically addressed these issues. The rule permits continued recovery of fixed costs through a minimum bill. Furthermore, customers remain obligated to pay all the fixed costs assigned to the demand and commodity components of a pipeline's rate. The Commission's action, therefore, protects full requirements customers and pipelines from bearing the cost of facilities constructed for customers that reduce their purchases below minimum bill levels.

2. There is also no basis for petitioners' claim that it was unreasonable for the Commission to decline to eliminate take-or-pay provisions in producer-pipeline contracts at the same time it eliminated variable-cost minimum bills. Petitioners argue that the two types of provisions are inextricably linked. They assert that, without the requirement to pay for variable costs in minimum bills, partial requirements customers will be able to switch more easily from their traditional pipeline suppliers to lower-cost pipelines, and the traditional suppliers will then be unable to meet their take-or-pay obligations.

The Commission gave considerable attention to this issue and concluded that "there is no clear nexus between a pipeline's annual take-or-pay obligations and its minimum commodity bills to its customers." (A-103.)[6] Reductions in purchases by any specific customer or group of customers will not necessarily result in increased pipeline take-or-pay liabilities to producers. For example, purchases by other customers may more than compensate for reductions in sales by partial requirements customers. In addition, most take-or-pay contracts contain make-up provisions that allow the pipeline to credit its take-or-pay payments against subsequent gas purchases that exceed take-or-pay levels, and make-up gas should be paid for by the customers that actually buy it and not by other customers that earlier reduced their purchases. (A-102 to A-105.) In any event, to the extent a pipeline incurs any take-or-pay costs,[7] the Commission's orders do not, as petitioners suggest, obligate full requirements customers to bear such costs, even in the short term. The rule leaves the allocation of any take-or-pay costs that are actually incurred for decision in the individual rate proceedings in which pipelines seek recovery of such costs. In those proceedings, the Com-

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[6] The Commission in any event was not legally required to resolve issues involving producer take-or-pay contracts at the same time it issued Order Nos. 380 and 380-A. As the court below found, "[a]n agency should not be paralyzed by having to decide all relevant issues at the same time. The agency's decision should be upheld unless the agency 'abuse[s] this flexibility by failing to consider . . . an issue whose resolution might seriously undercut the . . . rationale for its final action' . . . ." *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1159 (D.C. Cir. 1985) (citations omitted).

[7] The Commission acknowledged that initially there might be some cost shifting or take-or-pay cost increases on systems that lose partial requirements customers to other suppliers. It explained, however, that such shifts would be short-term and that all pipeline customers would benefit in the long term "as the industry moves towards a competitive balance." (A-99.)

mission can allocate such costs in a variety of ways. If the costs were not prudently incurred, the pipeline must bear them. If there is no finding of imprudence, the Commission could allocate costs to those customers that reduced their purchases, to those that switched to other suppliers, or to all customers. The Commission will also be free to develop other just bases for assigning such costs.

3. In their petition, Trunkline Gas Company and Panhandle Eastern Pipe Line Company have raised for the first time an argument that the Commission's orders conflict with the principles of the Natural Gas Policy Act (NGPA), by subjecting producer prices to market pressures (rather than only encouraging those prices to rise) and by interfering with the statutory mechanism for the pass-through of those prices. They did not raise this argument in the Court of Appeals at all and referred to it only fleetingly in their petition for rehearing before the Commission. Contrary to their arguments, the NGPA clearly contemplates that producer prices should be subject to market forces. *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi*, 106 S. Ct. 709, 716 (1986) (citing Sen. Rep. No. 95-436, at 10 (1977) ("new federal role is to 'oversee[e] a national price regulatory scheme' ")).[8]

4. There is no merit to petitioners' challenges to the rulemaking procedures that the Commission used in this

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[8] They also argue, more generally, that the Commission's orders promote head-to-head competition, in violation of principles of public utility regulation. However, the FERC's orders do not imperil recovery of fixed costs and thus retain significant protections from the allegedly adverse effects of competition. Moreover, the Natural Gas Act was not intended to prevent all competition among pipelines. Section 7 of the Act, by its terms, provides that the grant of a certificate does not confer a monopoly. 15 U.S.C. § 717f (1982). *See Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 959-61 (D.C. Cir. 1968).

case. Order No. 380 was issued pursuant to Section 5 of the Natural Gas Act, which authorizes the FERC to act "after a hearing." 15 U.S.C. § 717d (1982). This Court has held that informal rulemaking procedures may satisfy the requirement of a ratemaking hearing, *United States v. Florida East Coast Railway*, 410 U.S. 224, 241-42 (1973), and has consistently affirmed the authority of the FERC to establish rates on a nationwide basis through the use of informal rulemaking procedures. *FPC v. Texaco, Inc.*, 377 U.S. 33, 39-45 (1964); *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

In the Department of Energy Organization Act of 1977, Congress expressly sanctioned the FERC's use of informal rulemaking procedures for any ratemaking function set forth in the Natural Gas Act. 42 U.S.C. § 7173(c) (1982). Pursuant to that provision, the FERC need only "assure full consideration of the issues and an opportunity for interested persons to present their views." The proceeding leading to Order No. 380 comprised two rounds of written comments by interested parties. Ninety-five parties filed initial comments by September 29, 1983. On January 25, 1984, the Commission invited interested parties to file reply comments by February 13, 1984; thirty parties filed such comments. The Commission issued Order No. 380 on May 25, 1984. The FERC issued Order No. 380-A on July 30, 1984, in response to requests for rehearing, stay, or clarification filed by twenty-five parties.

No party demonstrated to the Court of Appeals that it had not been afforded full opportunity to present its views. The FERC and the Court of Appeals applied proper procedural standards, and there is no reason for this Court to review those standards. *See Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978).

The enormity of the problem facing pipeline customers and consumers had been made abundantly clear to the Commission by the time it issued the orders involved here. Distributors, consumer groups, and pipelines that bought gas from other pipelines had repeatedly challenged minimum bills, beginning in 1981. In all, twenty-four proceedings before the Commission had raised a minimum bill issue. Virtually every pipeline using minimum commodity bills was challenged. It was appropriate—indeed necessary—for the Commission finally to address and resolve this industry-wide problem on an industry-wide basis.

5. Petitioner ANR Pipeline Company (ANR) contends that the Court of Appeals' ruling upheld the authority of the FERC to abrogate the terms of settlement agreements that it has previously approved. The Court of Appeals, however, made no such ruling. As ANR itself notes in its Petition for Certiorari at 15, the Court of Appeals merely determined that the terms of the particular settlement agreement cited by ANR did not preclude the FERC from applying Order No. 380 to ANR. This narrow issue does not warrant review by this Court.

CONCLUSION

For the reasons stated, the petitions for a writ of certiorari should be denied.

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March 28, 1986

APPENDIX

APPENDIX

LIST OF RESPONDENTS' PARENTS, AFFILIATES, AND SUBSIDIARIES THAT ARE NOT WHOLLY-OWNED

Columbia Gas Transmission Corporation

Big Marsh Oil Company
Columbia Coal Gasification Corporation
Columbia Gas Development of Canada Ltd.
Columbia Gas Development Corporation
Columbia Gas of Kentucky, Inc.
Columbia Gas of Maryland, Inc.
Columbia Gas of New York, Inc.
Columbia Gas of Ohio, Inc.
Columbia Gas of Pennsylvania, Inc.
Columbia Gas of Virginia, Inc.
Columbia Gas System Service Corporation
Columbia Gulf Transmission Corporation
Columbia Hydrocarbon Corporation
Columbia LNG Corporation
Columbia Natural Resources, Inc.
Commonwealth Gas Pipeline Corporation
Commonwealth Gas Services, Inc.
Commonwealth Propane, Inc.
Inland Gas Company, Inc.
TriStar Gas Marketing, Inc. (pending SEC approval)

Consolidated Gas Transmission Corporation

Consolidated Natural Gas Company
The East Ohio Gas Company
The Peoples Natural Gas Company
Hope Gas, Inc.
CNG Producing Company
CNG Development Company
Consolidated System LNG Company
CNG Coal Company
CNG Research Company
West Ohio Gas Company

River Gas Company
CNG Energy Company
Consolidated Natural Gas Service Company, Inc.

Inter-City Gas Corporation

EKW Appliances, Inc.
Greater Winnipeg Gas Corporation
ICG Scotia Gas Ltd.
Keeprite, Inc.
Roam Communications Limited
The Mortgage Insurance Company of Canada
Vancouver Island Gas Company

Michigan Consolidated Gas Company

Primark Corporation

Michigan Gas Utilities Company

Michigan Energy Resources Company

Natural Gas Pipeline Company of America

Natural Gas Pipeline Company of America is a subsidiary of MidCon Corp., a majority of whose shares are owned by Occidental Petroleum Corporation.

MidCon Corp. is the parent of the following subsidiaries:

Alabama Gulf South Pipeline Company, Inc.
Alabama Methane Production Company
Anthrust, Inc.
Cotton Petroleum Corporation
Exeter Capital Corporation
Exeter Drilling Company
Exeter Exploration Company
Exeter Service Company
Gulf South Pipeline Company
Harper Oil Company
Lynx Drilling Company

MCN Acadian Gas Pipeline Corp.
MCN Bayou Interstate Pipeline Corp.
MCN Calcasieu Gas Gathering Corp.
MCN Coal Gasification Company
MCN Equities, Inc.
MCN Louisiana Industrial Gas
MCN Overseas Inc.
MCN Pelican Interstate Gas Corp.
MCN Pelican Transmission Corp.
MCN Pontchartrain Natural Gas Corp.
MCN Research, Inc.
MCN Spindletop Gas Distribution Corp.
MCN Technologies, Inc.
MCN Transmission, Inc.
MCN Utah Pipeline Corp.
MCN-TEX Corp.
MCN-Trinidad and Tobago LNG Company
MidCon Arkansas Pipeline Corp.
MidCon Colorado Pipeline Corp.
MidCon Acquisition Corp.
MidCon Enterprises, Inc.
MidCon Exploration Company
MidCon Gas Products, Inc.
MidCon General, Inc.
MidCon Holding Corp.
MidCon Hydrocarbons Corp.
MidCon Illinois Pipeline Corp.
MidCon International N.V.
MidCon Louisiana Pipeline Corp.
MidCon Michigan Pipeline Corp.
MidCon Mississippi Natural Gas Pipeline Corp.
MidCon Missouri Pipeline Corp.
MidCon Nebraska Pipeline Corp
MidCon New Mexico Pipeline Corp.
MidCon Oklahoma Natural Gas Pipeline Corp.
MidCon Plants, Inc.
MidCon Razorback Pipeline Corp.
MidCon Sales Inc.

MidCon Texas Pipeline Corp.
MidCon Ventures, Inc.
MidCon Wyoming Pipeline Corp.
MidOk Pipeline Company
MidTex Pipeline Company
Mississippi Gulf South Transmission Company
Mississippi River Transmission Corporation
NAERCO, Inc.
NGP-LNG, Inc.
Petrounited, Inc.
South Gulf Management, Inc.
TPC Pipeline Company
Texas Gulf South Pipeline Company
Texoma Production Company
Troy Potter Inc.
UER Gas Trading, Inc.
UER Marketing Company
UER Overseas Finance, N.V.
UER Services, Inc.
United Energy Resources, Inc.
United Energy Services Company
United Gas Pipe Line Company
United Texas Transmission Company
Western Energy Transport Company

The Peoples Gas Light and Coke Company

People's Energy Corporation

Process Gas Consumers Group

American Standard, Inc.
Armco, Inc.
Bethlehem Steel Corporation
Carpenter Technology Corporation
Cone Mills Corporation
Corning Glass Works
General Motors Corporation
Owens-Corning Fiberglas Corporation
Owens-Illinois, Inc.

(8) (5) (5) (5) (6)

Nos. 85-1219, 85-1236, 85-1237, 85-1250, and 85-1252

In the Supreme Court of the United States

OCTOBER TERM, 1985

Supreme Court, U.S.
FILED
APR 29 1986
JOSEPH F. SPANIOL, JR.
CLERK

TRANSWESTERN PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ANR PIPELINE CO., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TEXAS EASTERN TRANSMISSION CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TRUNKLINE GAS CO. AND
PANHANDLE EASTERN PIPE LINE CO., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ARKLA ENERGY RESOURCES, ETC., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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28 pp

QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission reasonably exercised its statutory authority to regulate natural gas pipeline rates by adopting a rule requiring pipelines to eliminate from their tariffs "minimum bill" provisions that permit a pipeline to charge a customer for the variable costs associated with a specified volume of gas even if the customer does not actually take delivery of the gas from the pipeline.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	3
Argument	14
Conclusion	23

TABLE OF AUTHORITIES

Cases:

American Public Gas Association v. *FPC*, 567 F.2d 1016, cert. denied, 435 U.S. 907	21, 22
American Textile Manufacturers Institute v. *Donovan*, 452 U.S. 490	18
Atlantic Refining Co. v. *Public Service Commission*, 360 U.S. 378	17
FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621	15, 17
Mobil Oil Corp. v. *FPC*, 417 U.S. 283	18
Pacific Gas Transmission Co. v. *FPC*, 536 F.2d 393, cert. denied, 429 U.S. 999	17
Permian Basin Area Rate Cases, 390 U.S. 747	15, 16
Phillips Petroleum Co. v. *FPC*, 475 F.2d 842, cert. denied, 414 U.S. 1146	21
SEC v. *Chenery Corp.*, 332 U.S. 194	22
Tenneco Oil Co. v. *FERC*, 571 F.2d 834, cert. dismissed, 439 U.S. 801	21
Transcontinental Gas Pipe Line Corp. v. *State Oil and Gas Board*, No. 84-1076 (Jan. 22, 1986)	19
United States v. *Florida East Coast Ry.*, 410 U.S. 224	21, 22
Vermont Yankee Nuclear Power Corp. v. *NRDC*, 435 U.S. 519	22

Statutes: Page

Department of Energy Organization Act, § 403(c), 42 U.S.C. 7173(c) 21
Natural Gas Act, 15 U.S.C. 717 *et seq.* 3
§ 5, 15 U.S.C. 717d 10, 11, 15, 21
§ 5(a), 15 U.S.C. 717d(a) 15
§ 7, 15 U.S.C. 717f 11, 16
§ 16, 15 U.S.C. 717o 10
§ 19(b), 15 U.S.C. 717r(b) 21

In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1219

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v.

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TEXAS EASTERN TRANSMISSION CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

No. 85-1250

TRUNKLINE GAS CO. AND PANHANDLE EASTERN PIPE LINE CO., PETITIONERS

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FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A56) is reported at 770 F.2d 1144.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. A71-A128, A129-A225, A226-A230, A231-A270, A271-A279) are reported at 27 F.E.R.C. ¶ 61,318; 28 F.E.R.C. ¶ 61,175; 29 F.E.R.C. ¶ 61,076; 29 F.E.R.C. ¶ 61,077; and 29 F.E.R.C. ¶ 61,332.

JURISDICTION

The judgment of the court of appeals (Pet. App. A57-A68) was entered on August 20, 1985, and petitions for rehearing were denied on October 25, 1985 (Pet. App. A69-A70). The petition for a writ of certiorari in No. 85-1219 was filed on January 21, 1986; the petitions in Nos. 85-1236 and 85-1237

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[1] "Pet. App." refers to the appendix to the petition in No. 85-1219.

were filed on January 22, 1986; and the petitions in Nos. 85-1250 and 85-1252 were filed on January 23, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.*, empowers the Federal Energy Regulatory Commission to regulate the rates charged by natural gas pipelines for sales of natural gas. This case involves a rule promulgated by the Commission pursuant to this statutory authority; the Commission barred natural gas pipelines from using "minimum commodity bills" to charge their customers for the variable costs associated with a specified volume of gas whether or not the customer takes delivery of that much gas. The Commission also prohibited the use of similar tariff and contract provisions requiring a customer to take physical delivery of a specified amount of gas.

a. The rates charged by natural gas pipelines generally consist of two basic components. A "demand charge" is imposed upon all customers who are entitled by contract to receive a specified amount of natural gas from the pipeline. As the court of appeals explained, this charge "is not levied upon each unit of gas sold, but rather is a fixed sum, assessed in proportion to the maximum quantity of gas the customer is entitled to demand under the contract. The demand charge thus recoups some portion of the fixed costs incurred by the pipeline in providing a transmission mechanism of sufficient capacity to meet the customer's peak-load minimum entitlement." Pet. App. A19; see also *id.* at A71-A72.

The second component of pipelines' rates is the "commodity charge" levied upon each unit of gas sold. It is through this charge that a pipeline recovers its variable costs as well as the fixed costs that are not recovered through the demand charge. Pet. App. A18-A19; A72. Some pipelines include in their rate schedules a specific type of commodity charge known as a "minimum commodity bill." These minimum bill provisions essentially establish a minimum commodity charge, requiring the customer to pay for a certain quantity of gas even if the customer does not take delivery of any gas during the relevant time period. *Id.* at A19; A72-A73.

The Commission in the past has permitted pipelines to utilize minimum bill provisions because these provisions assist in the recovery of fixed costs. Minimum bill provisions typically are imposed upon a pipeline's "partial requirements" customers—those customers with access to more than one pipeline supplier.[2] Partial requirements customers can "swing from one source of supply to another." Pet. App. A75; see also *id.* at A19. If a partial requirements customer takes less gas from a pipeline than the pipeline expected to sell, and the pipeline is unable to sell the gas elsewhere, the revenue received by the pipeline pursuant to its commodity charge will be reduced and the pipeline may fail to recover its fixed costs.

Minimum bills guarantee a minimum payment by partial requirements customers; they provide protection against underrecovery of fixed costs and ensure that partial requirements customers bear an appropriate share of fixed costs. Minimum bills also pre-

[2] "Full requirements" or "captive" customers are those who purchase their entire natural gas supply from one pipeline. Pet. App. A75.

vent pipelines from incurring the "take or pay" costs that can result when the pipeline's contract with its supplier provides that the pipeline will take a particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take or pay" payments to its supplier. Since minimum bills discourage partial requirements customers from shifting suppliers, they assist pipelines in avoiding take or pay costs. Pet. App. A19-A20.

If the pipeline does incur take or pay costs, these costs generally may be included in the pipeline's rate base; the take or pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take or pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it can recover prudently incurred take or pay costs. Pet. App. A20-A21; A78.

It is significant that the justifications for minimum bills traditionally focused upon the recovery of pipelines' fixed costs. As the Commission observed, "[t]he recovery of *variable* costs via minimum commodity bills [was] simply not an issue in the past. This is because interstate pipelines generally were buying all the gas they were offered * * * and because the major variable cost—the gas supply itself —represented a far smaller proportion of the minimum commodity bill than it does today." Pet. App. A79 (footnote omitted; emphasis in original); see also *id.* at A21.

b. In August 1983, the Commission issued a Notice of Proposed Rulemaking stating that it proposed

to eliminate minimum bills from pipelines' tariffs to the extent these provisions permitted the recovery of variable costs. The notice solicited comments from interested parties regarding the Commission's proposal. Pet. App. A22, A73-A74.

After considering comments from more than 90 parties, the Commission concluded that "collection of variable costs via a pipeline's minimum bill tariff provision is unjust and unreasonable under the Natural Gas Act" (Pet. App. A74). It promulgated a rule declaring "inoperative and of no effect at law" existing rate schedules and tariffs that provide for "recovery of purchased gas costs for gas not taken by the buyer"; the rule also bars the filing of new rate schedules or tariffs providing for "recovery of variable costs associated with gas not taken by the buyer" (*id.* at A123). Pipelines remain free to continue to utilize minimum bill provisions to recover their fixed costs.[3]

The Commission found that minimum bills had "become a vehicle by which enormous purchased

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[3] The Commission subsequently extended this rule to cover "minimum take" provisions, under which the customer is required to take physical delivery of a minimum quantity of gas and does not have the option of paying for gas not taken (see Pet. App. A231-A268). It concluded that "minimum take provisions operate to prevent purchasers from pursuing a least-cost purchasing strategy, thereby resulting in charges to customers in excess of the lowest reasonable rate consistent with reliable, long-term supply" (*id.* at A235) and found that minimum take provisions "share fully the market-distorting influences of the variable costs in minimum commodity bills" (*id.* at A236). The Commission therefore found that the same rule should apply to minimum take provisions, noting that a pipeline remained free to "seek recovery of fixed costs incurred as a result of a customer's failure" to meet its purchasing obligations (*ibid.*).

gas 'costs' can be collected even if the pipeline never actually incurs such costs" (Pet. App. A81). It stated (*id.* at A82):

> By definition, there are no variable costs incurred for volumes not purchased for resale. Accordingly, a minimum commodity bill that includes variable costs gives a pipeline the right to collect for "costs" it has not in fact paid out to provide jurisdictional natural gas service. On its face then, a minimum bill that permits such "cost" collection is unjust and unreasonable.

The Commission noted that the amounts of variable "costs" collected pursuant to minimum bills had increased dramatically as a result of the deregulation of natural gas prices: "gas prices have risen to the point that purchased gas costs make up the majority of a pipeline's variable costs and hence its commodity rate" (*id.* at A81). The elimination of variable costs from minimum bill provisions would prevent pipelines from reaping this financial windfall.

The Commission further found that minimum bills permitting recovery of variable costs had the effect of restraining competition, with the result that gas prices were " 'propped up' * * * at levels higher than the market would otherwise support" (Pet. App. A86 (footnote omitted)). A pipeline's "partial requirements customers cannot purchase lower cost gas supplies if they are required to pay for the higher-cost gas they do not take" (*id.* at A85). Minimum bill provisions thus insulate pipelines from market pressures: "[w]hen distributors and pipelines are required to purchase gas under a minimum commodity bill, even when less expensive sources are available, the supplier pipeline can continue to oper-

ate profitably without having to worry about keeping its gas costs at a reasonable level" (*id.* at A86).

Moreover, the Commission found that including variable costs in minimum bills "deprive[s] producers of the opportunity to increase sales volumes in exchange for accepting a reduction in price" (Pet. App. A87). This is because "[a] pipeline cannot offer to buy more gas from a producer that lowers its prices if that pipeline's customers are under minimum commodity bill obligations elsewhere" (*ibid.*); the pipeline would not be able to dispose of the larger quantity of gas because it would not be able to increase its own sales.

The Commission concluded that these significant adverse effects of permitting recovery of variable costs through minimum bill provisions outweighed any possible benefits of allowing such cost recovery. It first observed that the justifications traditionally advanced in support of minimum bill provisions concerned the recovery of fixed costs. This function was important when pipelines were making large investments in new facilities, but the Commission noted that "most pipelines are not in this situation" (Pet. App. A90). Many pipelines now use a rate approach that "permits recovery of more fixed costs in the demand charge and diminishes much of the formerly perceived need for minimum commodity bills" (*ibid.*). Moreover, pipelines using more traditional rate approaches still would be permitted to recover fixed costs through minimum bills; the rule bars only the inclusion of variable costs.

The Commission rejected claims that its new rule would adversely affect customers who rely upon a single pipeline as their only source of natural gas. The Commission noted that "viewed from a national

perspective, the rule may create offsetting benefits and detriments to captive customers, depending upon whether they are served by a high-cost or a low-cost pipeline" (Pet. App. A96-A97 (footnote omitted)). And customers of a high-cost pipeline would be protected from unwarranted rate increases through the Commission's regulation of pipeline rates under the Natural Gas Act (*id.* at A97-A100).

Finally, the Commission determined that pipelines should not be permitted to recover take or pay costs through minimum bills.[4] The Commission observed that a pipeline customer's decision to reduce its take of gas below minimum bill levels would not necessarily force the pipeline to incur take or pay costs. In addition, revenues from minimum bill provisions previously had not been viewed as compensating pipelines for take or pay costs; rather, "existing minimum commodity bills seem designed to prevent take-or-pay prepayments from being incurred in the first instance, by discouraging consumer cutbacks. This effect is * * * anti-competitive, unjust, and unreasonable." Pet. App. A103-A104.

Even if a pipeline did incur increased take or pay costs, "it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later" (Pet. App. A104). Requiring customers subject to minimum bills to absorb a pipeline's take or pay costs also would be inequitable, the Commission found, because

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[4] As discussed above (see page 5, *supra*), take or pay costs are costs incurred by a pipeline pursuant to a provision in the contract between the pipeline and its supplier requiring the pipeline to take delivery of a specified quantity of gas from the supplier or pay for that quantity of gas.

"full requirements customers not subject to a minimum commodity bill may be as much responsible for take-or-pay payments as swing customers who are subject to a minimum commodity bill" (*id.* at A105). If the pipeline "is permitted to 'cover' its take-or-pay costs via minimum bill charges, the customers subject to a minimum commodity bill will bear a disproportionate burden of the pipeline's take-or-pay obligations" (*ibid.*).[5]

2. The court of appeals unanimously affirmed the Commission's decision in virtually all respects (Pet. App. A1-A56).[6]

The court first addressed the Commission's statutory authority to issue the rule barring recovery of variable costs through minimum bill provisions. It stated that Section 5 of the Natural Gas Act, 15 U.S.C. 717d, empowers the Commission to fix "just and reasonable" rates and found that this authority, combined with the Commission's general rulemaking power (see 15 U.S.C. 717o), justified the issuance of the rule (Pet. App. A24-A25). The court also rejected several challenges to the Commission's statutory authority. First, it found that the elimination of variable costs from minimum bill provisions did

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[5] The Commission observed that the allocation of take or pay costs among pipeline customers might present special considerations warranting the allocation of such costs in a manner different from the allocation of other costs. It directed the Commission staff to study this question and address the issue in individual pipeline rate proceedings. Pet. App. A105-A107.

[6] The court remanded for further consideration the Commission's decision that downstream pipelines cannot recover through minimum bills certain fixed costs that their pipeline suppliers may include in minimum bills. Pet. App. A46-A50.

not constitute an impermissible revocation of the conditions of the certificates of public convenience and necessity issued to pipelines under Section 7 of the Natural Gas Act, 15 U.S.C. 717f. The court noted that certification of a pipeline's initial terms of service does not constitute a guarantee that those terms will not be changed pursuant to the Commission's authority to regulate rates under Section 5 (Pet. App. A25 n.9). Moreover, the court held, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The Order merely addressed the *rates* the pipeline may charge its customers and therefore was properly issued pursuant to section 5" (*ibid.* (emphasis in original)).

Second, the court rejected arguments that the rule impermissibly altered the terms of existing contracts, holding that "section 5 gives the Commission authority to alter terms of any existing contract found to be 'unjust' or 'unreasonable'" (Pet. App. A25-A26 n.9). Third, the court concluded that various settlement agreements in rate proceedings did not bar the Commission from adopting the rule; the court found that the rule did not conflict with the terms of the settlements (*id.* at A26-A29).[7]

On the merits, the court held that the Commission's decision to adopt the rule was supported by substantial evidence. The court identified (Pet. App. A33) "[t]hree essential findings" underlying the Commission's determination:

> First, minimum bills allow pipelines to recover for various costs that they do not incur. Second,

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[7] The court also held that the application of the rule to imported gas was not inconsistent with the Economic Regulatory Administration's authorization of the importation of that gas (Pet. App. A30-A31).

> minimum bills prevent gas purchasers from purchasing the lowest priced gas and hence artificially maintain high gas prices. Third, the benefit of eliminating variable cost recovery through minimum bills outweighs the negative impact such action will have upon pipelines and upon full requirements customers.

The court held that "the factual support for the overrecovery rationale is unassailable. Minimum bills allow [a] pipeline[] to charge for gas that its customer does not take; if the customer pays for gas not taken, the pipeline recovers for variable costs that it does not incur" (Pet. App. A33). The circumstance that a particular pipeline actually may not have overrecovered its costs did not undercut the Commission's conclusion, but "merely reflects the rational choice of its partial requirements customers to take gas that they must pay for rather than pay for gas not taken. The lynchpin [*sic*] of the Commission's rationale, however, is the *potential* for overrecovery" (*id.* at A33-A34 (emphasis in original)).

The court also upheld the Commission's determination that the record showed that minimum bills adversely affect competition. The court emphasized that the Commission's determination did not rest solely upon economic theory, observing that "[t]he record is replete with comments from customers who have been unable to purchase lower cost gas because of minimum bills and minimum take provisions" (Pet. App. A36 (footnote omitted)). The court concluded that "[e]ven if some customers do not pursue * * * [a least cost purchasing] strategy, the Commission has presented evidence that many customers will, and thus the elimination of minimum bills can reasonably be expected to lower gas costs and spur competition among pipelines" (*id.* at A37).

The court also upheld the Commission's determination that the benefits of eliminating variable costs from minimum bills outweighed any potential harms to pipelines and captive customers from that course of action. The court noted that "[t]he Commission gave considerable attention to the difficult take-or-pay issue" (Pet. App. A38). It agreed with the Commission that reductions in purchases by partial requirements customers would not necessarily result in take or pay liability and that pipelines could avoid take or pay costs by lowering prices to maintain sales. The court further noted that the increased price competition resulting from elimination of minimum bills "may spur renegotiation of take-or-pay clauses with gas producers" (*id.* at A39).

The court recognized "that many of the policy considerations that support the elimination of variable cost recovery for the minimum bill might support the elimination of take-or-pay clauses" (Pet. App. A39-A40), but it upheld the Commission's decision to take action only with respect to minimum bills. The court observed that the agency was not required to address all problems in a single rulemaking; rather, "[t]hat which we can require, the Commission has here provided: an explicit assessment of the relationship between the action taken and the issue deferred, and a reasonable conclusion that the public interest can best be advanced by the measured step taken" (*id.* at A40).

The court also determined that the Commission had adequately considered claims that pipelines' captive customers would bear increased costs if the pipelines lost sales (Pet. App. A41-A42). The court stated that "[h]ad the Commission either failed to address the problems faced by captive customers or

engaged in a less than candid balancing of the costs, its determinations perhaps would be vulnerable on review. The Commission, however, exhaustively considered these problems, recognized that some harm would result from the elimination of minimum bills, indicated it would consider in individual cases whether particular cost swings warrant special allotment of costs, and, finally, concluded that the benefit of increased competition would eventually inure to even the captive customer of a high-priced pipeline. These are the hard choices agencies are empowered—indeed required—to make" (*id.* at A41-A42).

Finally, the court affirmed the Commission's decision to address the minimum bill issue through a rulemaking proceeding rather than in pipeline-by-pipeline adjudications. It found that the "generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the systemic problems of the natural gas market" (Pet. App. A52) (footnote omitted)).[8]

ARGUMENT

The thorough opinion of the court below, upon which we rely, is correct and does not conflict with any decision of this Court or another court of appeals. Further review by this Court is not warranted.

1. Petitioners present two challenges to the Commission's statutory authority to issue a rule prohibiting recovery of variable costs through minimum bills. First, petitioners argue (85-1219 Pet. 10-11; 85-1237

[8] The court also upheld the Commission's decision granting an exemption from the rule to one pipeline company (Pet. App. A43-A46).

Pet. 8-10) that the rule destroys the mutuality of obligation between pipelines and their customers. The court of appeals properly characterized this claim as "frivolous" (Pet. App. A25 n.9).

Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), expressly provides that "[w]henever" the Commission finds that "any rate [or] charge" or "contract affecting such rate [or] charge" is "unjust, unreasonable, unduly discriminatory, or preferential," the Commission shall determine the "just and reasonable rate, charge, * * * or contract to be thereafter observed and in force, and shall fix the same by order." As this Court has recognized, Section 5 confers upon the Commission "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-784 (1968); see also *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 646-647 (1972). In *Permian Basin*, the Court upheld an order issued by the Federal Power Commission that barred the use of escalation clauses in existing contracts; the order in this case invalidating another sort of unreasonable contract provision therefore plainly falls within the Commission's statutory authority.[9]

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[9] Petitioners' references (85-1219 Pet. 8-10) to the role of contracts under the Natural Gas Act are irrelevant. Contract provisions cannot remain in effect when they contain terms found by the Commission to be unlawful under Section 5.

Petitioners observe (85-1219 Pet. 13-14) that the minimum bill provisions were approved by the Commission in earlier proceedings. This Court in *Permian Basin Area Rate Cases, supra*, recognized that such prior administrative action was immaterial; it declined to set the Federal Power Commission's order aside "merely because the Commission ha[d] on an earlier occasion reached another result; administrative author-

Moreover, petitioners' argument is completely insupportable in the present context because petitioners have not been deprived of the principal benefit of minimum bill provisions. Pipelines are barred only from recovering variable costs (principally the cost of purchased gas), and a pipeline will not incur this cost if the customer chooses not to purchase the gas. Thus, the minimum bill provision still fulfills its purpose of assisting pipelines in recovering their fixed costs; pipelines simply cannot recover variable costs for gas that they do not sell.[10]

Second, petitioners assert (85-1219 Pet. 22-25; 85-1252 Pet. 8-14) that the Commission lacks authority to issue the rule because the rule alters the terms of certificates of public convenience and necessity previously issued by the Commission pursuant to Section 7 of the Natural Gas Act, 15 U.S.C. 717f. Section 7 provides that a natural gas company must obtain a certificate of public convenience and necessity before it begins operations; the circumstance that a minimum bill provision was one of the terms and conditions of a pipeline's original certificate is simply irrelevant here. As the court of appeals observed, "elimination of minimum bills has no effect on the pipeline's *authorized* service. The [Commission's] Order merely addresses the *rates* the pipeline may

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ities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances" (390 U.S. at 784).

[10] Petitioners argue (85-1219 Pet. 21-22) that they will be unable to recover take or pay costs but, as we discuss below (see pages 19-20), it is not clear that the rule regarding minimum bills will result in the imposition of take or pay costs upon pipelines and, in any event, recovery of these costs traditionally has not been a purpose of minimum bills.

charge its customers and therefore was properly issued pursuant to Section 5" (Pet. App. A25 n.9 (emphasis in original)).

Once a certificate of public convenience and necessity authorizing pipeline service is issued by the Commission, the pipeline becomes subject to the Commission's authority to set "just and reasonable" rates. The Commission is free to utilize its Section 5 rate regulating authority to alter the rates contained in the original certificate. See *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. at 643, 646-647 (Commission may use its Section 5 authority to regulate rates to release pipelines from their obligation to deliver certificated quantities of gas "whether or not it could also invoke § 7 for that purpose"); *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 392 (1959); *Pacific Gas Transmission Co.* v. *FPC*, 536 F.2d 393, 395-397 (D.C. Cir.), cert. denied, 429 U.S. 999 (1976). The Commission otherwise would be powerless to adjust the rate terms set forth in the original certificate. Indeed, the Commission itself concluded that Section 5 "*require*[*s*] the Commission to change terms and conditions under which a pipeline renders a certificated service if those terms and conditions result in rates and charges which are subsequently found unjust and unreasonable" (Pet. App. A135 (emphasis in original)).[11]

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[11] Petitioner Arkla Energy Resources claims (85-1252 Pet. 10-12) that the Commission may not use its Section 5 authority to prohibit minimum take provisions. However, the Commission's Section 5 authority extends to all terms and conditions of service affecting rates and charges; minimum take provisions plainly fall within this category. See page 6 note 3, *supra*.

Petitioner ANR Pipeline Co. asserts (85-1236 Pet. 14-16) that the Commission exceeded its statutory authority in prom-

2. Most of the arguments advanced by petitioners relate to the propriety of the Commission's policy determination. The court of appeals' thorough analysis of these issues (Pet. App. A32-A50) conclusively demonstrates that substantial evidence supports the Commission's decision to bar recovery of variable costs through minimum bills. This Court has stated repeatedly that the courts of appeals bear principal responsibility for determining whether an agency's decision is supported by substantial evidence; this Court will intervene only when the court of appeals has "misapprehended or grossly misapplied" the standard of review. *American Textile Manufacturers Institute* v. *Donovan*, 452 U.S. 490, 523 (1981); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-310 (1974). Petitioners do not even come close to showing that the court of appeals committed such an error here.

Petitioners do not dispute that recovery of variable costs through minimum bills results in a windfall to

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ulgating the rule because the rule abrogates a rate proceeding settlement agreement to which the Commission was a party. The court of appeals correctly concluded (Pet. App. A27-A29) that the rule did not abrogate the settlement agreement. The settlement agreement "merely defers resolution of the minimum bill issue" (*id.* at A29) and expressly states that "no party waives any rights with respect to the substantive standards for decision which should be applied herein" (85-1236 Pet. B1-B2). Thus, the settlement did not exclude the issue from the general rulemaking proceeding (Pet. App. A29).

Moreover, the Commission surely was correct in concluding (Pet. App. A110) that it may utilize its Section 5 rate regulating authority to alter a provision of a settlement agreement. Otherwise, the Commission could be bound forever by a settlement, regardless of how unjust or unreasonable the terms of the settlement had become.

a pipeline because the pipeline has not sold any gas and therefore has not incurred any variable costs. Several petitioners do assert that the Commission erred in concluding that the provisions are anticompetitive (85-1219 Pet. 18-20) or that the Commission should not have considered competition in its analysis (85-1237 Pet. 7; 85-1250 Pet. 10-15). But the Commission surely did not err in concluding that the effect of minimum bill provisions upon competition is a factor that may be considered in assessing the reasonableness of the provisions under Section 5. Congress itself has placed great emphasis upon encouraging reliance upon market forces in the natural gas industry. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, No. 84-1076 (Jan. 22, 1986), slip op. 11. And petitioners have not presented evidence contradicting the Commission's careful analysis of the competitive effect of these provisions. See Pet. App. A34-A37, A85-A92; see also pages 7-8, *supra*.

Petitioners' basic argument (85-1219 Pet. 21-22; 85-1236 Pet. 9-14; 85-1237 Pet. 14-15; 85-1250 Pet. 15-19) is that pipelines will be harmed financially by the Commission's rule because they will be required to bear take or pay costs. But the Commission and the court of appeals agreed that the elimination of variable costs from minimum bills would not necessarily result in the imposition of take or pay liability upon pipelines. The Commission summarized its conclusions as follows:

> [C]ustomer cutbacks below minimum bill levels may not cause *any* take-or-pay costs. Second, even if take-or-pay payments do result from such cutbacks, existing minimum commodity bills generaly [*sic*] do not serve to compensate for the

> cost of the take-or pay gas, and thus do not protect a pipeline's remaining customers from any resulting rate increases. Third, it is not clear that minimum commodity bills should force customers that cut back below minimum levels to compensate for the cost of any prepaid gas, since other customers may take that gas later.

Pet. App. A104 (emphasis in original); see also *id.* at A39.

Petitioners argue that the new rule will affect their "very viability as * * * continuing entit[ies]" (85-1250 Pet. 17) and that they have been placed in "a contractual vise" (85-1237 Pet. 14), but these assertions were for the Commission to evaluate. As the Commission and the court of appeals observed, pipelines might be able to sell the requisite quantity of gas by lowering prices, or they might be able to eliminate or reduce their take or pay obligations through renegotiation with gas producers. Pet. App. A39, A172, A182-A183. Moreover, a pipeline that does incur take or pay costs generally may include those costs in its rate base and, if necessary, can recover prudently incurred take or pay costs from its customers (see page 5, *supra*). Thus, a variety of methods are available to pipelines to ameliorate potential take or pay liability.[12]

3. Petitioners also contend (85-1219 Pet. 12-17; 85-1237 Pet. 10-13) that the Commission erred be-

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[12] Petitioners state in conclusory terms that the rule adopted by the Commission will increase costs for captive customers of pipelines (85-1236 Pet. 8, 10), but they present no evidence contradicting the Commission's conclusion that such customers will benefit in the long term from the elimination of variable costs from minimum bills and can be protected in the interim from improper rate increases (Pet. App. A95-A100).

cause it implemented its new policy regarding minimum bills by issuing a rule rather than undertaking individual pipeline-by-pipeline adjudications. These claims are without merit.

The Commission plainly has statutory authority to set rates and charges by rulemaking rather than adjudication. Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), states that the Commission may establish just and reasonable rates "after a hearing," but the provision has not been construed to require a formal evidentiary hearing in every case. *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 840-841 (5th Cir.), cert. dismissed, 439 U.S. 801 (1978); *American Public Gas Association* v. *FPC*, 567 F.2d 1016, 1064-1067 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978); *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842, 848-851 (10th Cir. 1973), cert. denied, 414 U.S. 1146 (1974); see also *United States* v. *Florida East Coast Ry.*, 410 U.S. 224, 241 (1973) (statutory requirement of a hearing satisfied by written comments). Moreover, Section 403(c) of the Department of Energy Organization Act, 42 U.S.C. 7173(c), provides that "[a]ny function * * * which relates to the establishment of rates and charges under the * * * Natural Gas Act * * * may be conducted by rulemaking procedures." Since the present proceeding obviously relates to "rates and charges," Section 403(c) authorized the Commission to proceed by rulemaking.

Petitioners surely are incorrect in asserting (85-1219 Pet. 15-17) that because the Commission's ratemaking decisions are reviewed under the "substantial evidence" standard (see 15 U.S.C. 717r(b)), the Commission may only set rates through adjudicatory proceedings. The standard of review applicable to an administrative decision does not affect the proce-

dure that the agency must follow in reaching that decision. Pet. App. A54-A55; *American Public Gas Association* v. *FPC*, 567 F.2d at 1067; see also *United States* v. *Florida East Coast Ry., supra.* Indeed, a contrary conclusion would conflict directly with this Court's determination in *Vermont Yankee Nuclear Power Corporation* v. *NRDC*, 435 U.S. 519 (1978), that a court may not "overturn [a] rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the [Nuclear Regulatory] Commission so long as the Commission employed at least the statutory *minima*" (435 U.S. at 548).[13]

In view of the Commission's statutory authority to proceed by rulemaking, its decision to select that course of action plainly is not subject to challenge. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947) ("the choice made between proceeding by general rule or by individual ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency"). The court of appeals correctly concluded that "[t]he generalized nature of the problems addressed * * * did not require trial-type procedures appropriate for retrospective determination of specific facts about individual parties. Rather, notice and comment rulemaking * * * was a manifestly reasonable method of addressing the sys-

[13] Petitioners contend that the rule set forth by this Court in *Vermont Yankee* is not applicable here because the present proceeding involves "fact-specific findings affecting a limited number of companies" (85-1219 Pet. 17). Petitioners' assertion is incorrect. The type of costs that may be recovered through minimum bills is a general issue affecting all natural gas pipelines that involves industry-wide questions; it therefore properly was addressed by the Commission through a rulemaking proceeding. See Pet. App. A52.

temic problems of the natural gas market" (Pet. App. A52 (footnote omitted)).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER TERM, 1985

ARKLA ENERGY RESOURCES,
a division of Arkla, Inc.
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF OF PETITIONER ARKLA ENERGY RESOURCES

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May 1986

TABLE OF AUTHORITIES

Page

JUDICIAL DECISIONS

FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972) 2

Reynolds Metals Co. v. *FPC*, 534 F.2d 379 (D.C. Cir. 1976) 3

Transcontinental Gas Pipe Line Corp., 488 F.2d 1325 (D.C. Cir. 1973), *cert. denied*, 417 U.S. 917 (1974) 3

ADMINISTRATIVE DECISIONS

Panhandle Eastern Pipe Line Co., 24 FERC ¶ 61,337 (1983), *rev'd on other grounds*, *Northern Natural Gas Co.* v. *FERC*, 785 F.2d 338 (D.C. Cir. 1986) 3

Trunkline LNG Co., 22 FERC ¶ 61,245 (1983). 3

STATUTES

Natural Gas Act:

Section 5, 15 U.S.C. § 717d (1982)..... *passim*

Section 7, 15 U.S.C. § 717f (1982) ..... *passim*

structure of the NGA and that, if accepted, would destroy the reliability of certificates on which billions of dollars of investment have been predicated.

The Commission's legal argument is confined to the assertion of its undisputed power "to utilize its Section 5 rate regulating authority to alter the rates contained in [a] certificate." Comm'n Br. at 17.[1] At most, the Commission's authority to alter rates provides support for that portion of its orders addressing minimum bill provisions. Minimum bills require the payment of funds and could arguably affect the per unit rate paid for gas taken by a pipeline's customer.

The Commission plainly overreaches, however, in asserting that its NGA Section 5 rate-setting authority empowers it to eliminate minimum take obligations. Comm'n Br. at 17 n.11. In fact, in another part of its brief, the Commission properly describes a minimum take obligation as a non-rate term:

> under which the customer is required to take physical delivery of a minimum quantity of gas and does not have the option of paying for gas not taken.

Comm'n Br. at 6 n.3. The obligation of the purchaser to take a specified quantity obviously has nothing to do with the seller's rates or rate structure. Unlike a minimum bill provision, a minimum take obligation can never require a purchaser to pay more per unit for gas it has taken than the just and reasonable rate established by the Commission. Rather than being rate-related, minimum take requirements constitute an essential aspect of the pipeline's service obligation. *See* Arkla Pet. at 3 nn.3-4 and accompanying text.

The Natural Gas Act draws a clear line between the authority to establish just and reasonable rates—NGA Sections 4 and 5—and

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[1] With one exception, all of the cases on which the Commission relies for its legal position involve changes in rates or billing mechanisms. Comm'n Br. at 17. The exception is the decision in FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972), which Arkla has shown is inapposite here. Arkla Pet. at 12.

the power to authorize service consistent with the public convenience and necessity—NGA Section 7.[2] Core features of service, such as quantity provisions, can only be altered if the procedures and standards of NGA Section 7 are observed. *See Reynolds Metals Co. v. FPC*, 534 F.2d 379 (D.C. Cir. 1976); *Panhandle Eastern Pipe Line Co.*, 24 FERC ¶ 61,337, at 61,715-16 (1983), *rev'd on other grounds, Northern Natural Gas Co. v. FERC*, 785 F.2d 338 (D.C. Cir. 1986).

The Commission does not contest the proposition that in order to accomplish fundamental changes in certificated service, a pipeline or other interested person must proceed under the certificate or abandonment provisions of NGA Section 7. The Commission claims, however, that it alone is not so constrained. The Commission's attempt to draw within its NGA Section 5 rate-setting authority the power to alter certificated quantity provisions is inconsistent with the statutory framework. Indeed, if the Commission's interpretation of the NGA were accepted, the Commission would be empowered to alter any provision of certificated service no matter how central that provision is to the service. The Commission has itself stated that even if it has such authority—a proposition about which it expressed substantial doubt—it could not alter certificated service except under very limited conditions not present here. *Trunkline LNG Co.*, 22 FERC ¶ 61,245, at 61,442 (1983).

In its orders, the Commission declined to discuss the relationship between its eradication of minimum take obligations and its admittedly limited, and perhaps non-existent, authority to alter certificates. The court below likewise failed to address this question, erroneously accepting the Commission's assertion that the issue involved only a matter of rates. The legal question presented by Arkla—one which affects the sanctity of certificates on which the

[2] The distinction between NGA Sections 5 and 7 is both procedural, Arkla Pet. at 11 n.12, and substantive. For example, application of the substantive criteria of NGA Section 7 would compel the Commission, before altering a minimum take obligation, to undertake a broad comparison of the interests of Arkla, its customer with a minimum take obligation, and the stockholders and consumers of both companies. *See* Transcontinental Gas Pipe Line Corp. v. FPC, 488 F.2d 1325, 1328-30 (D.C. Cir. 1973), *cert. denied*, 417 U.S. 917 (1974). As evidenced by the orders at issue here, the Commission does not engage in such a comparative analysis under NGA Section 5.

entire interstate natural gas pipeline industry is based—should be fully and fairly addressed.

Accordingly, this court should issue a writ of certiorari to review the judgment of the court below.

Respectfully submitted,

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